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by

William E. Harris

December 1994

Principal Advisor: Mark J. Eitelberg

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# MILITARY COMPENSATION AND THE ALL-VOLUNTEER FORCE: LESSONS LEARNED

by

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Major, United States Marine Corps
B.A., University of North Carolina, 1980

Submitted in partial fulfillment
of the requirements for the degree of

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## ABSTRACT

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## LIST OF SYMBOLS, ACRONYMS, AND/OR ABBREVIATIONS

| | |
|---|---|
| ~ | approximately |
| % | percent |
| $ | U.S. currency |
| AFQT | Armed Forces Qualification Test |
| AVF | All-Volunteer Force |
| BAQ | Basic Allowance for Quarters |
| BAS | Basic Allowance for Subsistence |
| CBO | Congressional Budget Office |
| CPI | Consumer Price Index |
| DECI | Defense Employment Cost Index |
| DMC | Defense Manpower Commission |
| DoD | Department of Defense |
| ECI | Employment Cost Index |
| FSA | Family Separation Allowance |
| FY | Fiscal Year, October 1-September 30 |
| GAO | General Accounting Office |
| GS | General Schedule |
| MCBP | Military Compensation Background Papers |
| MTS | Major Topical Summary |
| NSIAD | National Security and International Affairs Division |
| OHA | Overseas Housing Allowance |
| OSD | Office of the Secretary of Defense |
| PATC | Professional, Administrative, Technical, and Clerical |
| QRMC | Quadrennial Review of Military Compensation |
| RMC | Regular Military Compensation |
| RRB | Regular Reenlistment Bonus |
| S&I | Special and Incentive Pays |
| SRB | Selective Reenlistment Bonus |
| SSB | Selective Separation Bonus |

| | |
|---|---|
| VEAP | Post-Vietnam Veterans' Educational Assistance Program |
| VHA | Variable Housing Allowance |
| VRB | Variable Reenlistment Bonus |
| VSI | Voluntary Separation Incentive |

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# I. INTRODUCTION

## A. OVERVIEW OF RESEARCH AND METHODOLOGY

General research methodology required extensive background research on the concept of the All-Volunteer Force (AVF). Specific research was conducted on the development and progression of the compensation program from the time of the Gates Commission (The President's Commission on an All-Volunteer Armed Force) through the present. Analysis of identified major program changes was accomplished with the aid of studies by established research centers such as the RAND Corporation, Congressional Budget Office (CBO), General Accounting Office (GAO), and others. Their studies were used to support formulation of "lessons learned," which are the basis of this study.

Research centered on three major areas: market or institutional bases for compensation, standardizing approaches to military compensation, and potential problems. Each topic is handled as a separate chapter within this study.

## B. OVERVIEW OF ALL-VOLUNTEER FORCE CONCEPTS AND PRINCIPLES

The concepts of forced military obligations and voluntary service for the male population of the United States has been openly debated since the American Revolution. George Washington established the foundation for forced military obligations when he stated

> It must be laid down as a primary position, and the basis of our system, that every citizen who enjoys the protection of a free Government, owes not only a proportion of his property, but even of

his personal services to the defence of it....
(O'Sullivan and Meckler, 1974, p. xv).

The second amendment of the American Constitution, guarantying the right to bear arms, was based on the belief that every individual bore the responsibility for defense through the established militia system--not only for defense against outside foes, but potential internal tyrants or despots as well. The concept of a standing army at the federal level often came in direct conflict with emerging states rights advocates. The political, social, and economic development of the country was hotly debated by early politicians. The country's direction was uncertain, but all citizens bore the responsibility for the defense of its hard-earned freedom. The basic question was: "How should it be defended?" Although some early leaders such as Washington proposed universal military service, the idea was never fully accepted and volunteerism became the underlying principle for military obligation in America.

Throughout the next two-hundred years the United States witnessed the on-again, off-again use of a draft to meet military requirements. The ideas of standing armies and universal military service were continually debated as the nation struggled to define itself. However, a common philosophy opposed to conscription seemed to gain acceptance throughout the United States. Popular actions supporting voluntary militia service and individual liberties after the American Revolution and the exemptions, commutations, and substitutions allowed during the Union and Confederate drafts of the Civil War all served to heighten acceptance of voluntary military service. Through the Second World War, the use of conscripts was generally restricted to wartime. Mass peacetime conscription was not employed until after World War II when the United States determined that it needed a larger standing army than it could afford. The

need for such a large, standing army was created by the occupations of Germany and Japan and as a counter-power to the emergent Union of Soviet Socialist Republics. However, the perceived inequalities with the post-1940s draft supported Senator Robert A. Taft's position when "he spoke of recruiting 'by voluntary means' as 'in the American tradition'." (O'Sullivan and Meckler, 1974, p. xviii)

The debate over voluntary military service or conscription intensified when President Johnson's National Advisory Committee on Selective Service reported its findings in 1967. Commonly referred to as the Marshall Commission Report, it recommended some changes to the selective service system, but did, in fact, retain conscription as the basis for military service. However, with the election of Richard Nixon in 1968, major changes to the system were considered. President Nixon appointed a commission to study the concept of an AVF. The President's Commission on an All-Volunteer Force, or Gates Commission, recommended removing reliance on the selective service system and implementing an AVF. Specifically, the Commission stated, "We unanimously believe the nation's interests will be better served by an all-volunteer force, supported by an effective stand-by draft...." (Gates Commission, 1970, p. iii) President Nixon subsequently adopted the recommendations of the Gates Commission.

Recognizing that the role of a standing military continued to be a polarizing issue, the commission stated in its 1970 report that a

> fundamental consideration that has guided this commission is the need to maintain and improve the effectiveness, dignity, and status of the armed forces so they may continue to play the proper role (Gates Commission, 1970, p. 5).

The shift to an AVF was expected to ensure the proper role of the military by strengthening freedoms; allowing expressions of patriotism; promoting efficiency in the armed forces; and enhancing dignity in the armed forces. (Gates Commission, 1970, p. 6)

Individualism and free choice are two concepts associated with the United States. Since the nation's initial founding and subsequent expansion westward, Americans have placed high value on the capabilities of individual citizens to not only survive, but excel, on their own merits. The ability to make individual decisions and live with the consequences is deeply rooted in American cultural heritage. Adopting a voluntary military force enhanced this freedom. It allowed individuals to choose for themselves the road in life they wanted to follow.

The shift to an AVF matched the strengthening of freedoms with expressions of patriotism. Every major conflict the United States has engaged in since the American Revolution has generally borne out the belief that most Americans are patriotic and support the objectives of its government. However, in the late 1960s the unpopularity of the Vietnam War served as a catalyst to provoke a backlash against the selective service system. Observers began to question the patriotism of American youth. The Gates Commission felt an AVF would allow the "expression of the patriotism that has never been lacking among our youth." (Gates Commission, 1970, p. 6)

Other arguments against the draft were purely economic in nature. Major economic arguments against the draft centered on the ineffectiveness of the "tax-in-kind," wages paid to conscripts, and lost opportunity for individuals who had better alternatives than conscripted service. Suffice it to say, theoretically, an AVF would counteract these draft disadvantages and promote efficiency within the armed

forces. Cooper and Rostker stated that "one of the major effects of the draft was to remove the military from the focus of the market place." (Cooper and Rostker, 1974, p. 2) The AVF would place the military into direct competition with other employers and educational institutions for limited quantities of eligible men. By doing so, the armed forces had to become more efficient in their wages, work requirements, and conditions of employment to successfully attract required personnel.

A major objective of the AVF was to instill a sense of dignity in the military services. To achieve enhanced dignity in the Armed Forces, the Gates Commission was relying on the presence of all "true" volunteers and increased pay and benefits to positively affect the morale and dignity of the military. Because of the threat of conscription, no precise numbers exist to identify exactly how many first-termers were "true" volunteers or "volunteers" only to avoid conscription. The latter group, coupled with the conscripts, were occasional sources of malcontent within the armed forces. The intent was to fill the ranks with individuals who desired to serve and pay an adequate wage to attract and retain them. Table 1-1 illustrates the estimated percentage of "true" volunteers in the armed forces prior to the AVF.

Table 1-1 demonstrates how small the actual proportion of volunteers was for the armed forces. The majority of new accessions were either draftees or draft-motivated enlistees who joined to avoid the stigma of being drafted. This large percentage has often been cited as part of the disciplinary problems and costs of the draft era. The intent of the commission was to employ only individuals who wanted to serve in the armed forces and thereby remove some of the problems that seemed to accompany the draft.

Table 1-1

Enlisted Military Manpower Procurement (thousands)

| Source of Procurement | Fiscal Year | | | | | |
|---|---|---|---|---|---|---|
| | 1960 | 1964 | 1968 | 1970 | 1972 | 1974 |
| Total | 414 | 496 | 853 | 631 | 424 | 391 |
| Inductions | 90 | 151 | 340 | 207 | 27 | 0 |
| Enlistments | 324 | 345 | 513 | 424 | 397 | 391 |
| True Volunteer | 158 | 183 | 223 | 210 | 330 | 391 |
| Draft-Motivated | 166 | 162 | 290 | 214 | 67 | 0 |
| % True Volunteer | 38 | 37 | 26 | 33 | 78 | 100 |

Source: Adapted from Richard. V. L. Cooper, Military Manpower and the All-Volunteer Force, 1977, p. 20.

## C. OVERVIEW OF MILITARY COMPENSATION CONCEPTS FOR THE ALL-VOLUNTEER FORCE

The military pay system is generally comprised of basic pay, basic allowance for quarters (BAQ), and basic allowance for subsistence (BAS). Basic pay is a function of the individual's grade and time-in-service. It is heavily weighted towards seniority based upon the individual's time-in-service. This is codified through a closed manpower system and internal labor market that, with few exceptions, obtains its leaders entirely from within. The quarters and subsistence allowances are provided in lieu of free government housing or meals. An individual may obtain either free government housing or a quarters allowance. In some circumstances, both may be granted with special

authorization. These allowances are not taxable and led to the use of the "tax advantage" calculations as part of compensation considerations. Tax advantage is basically the difference between the amount of money received by service members as non-taxable and the amount that they would have to pay in taxes if the money were taxable. The tax advantage computations have had a significant impact on the compensation received by service members over the years. Finally, although not a regular part of military compensation, the Services employ incentive systems to attract and retain individuals in hard-to-fill fields or during times of poor retention. Appendix A contains a list of all pay and allowances to illustrate the complexity of the compensation system.

The military draft further complicated the compensation system by imposing a "tax" on draftees. The Gates Commission intended to capture the tax-in-kind paid by draftees and spread the cost of the military to all taxpayers. (Gates Commission, 1970, p. 25) The logic is that individuals would volunteer for the armed forces at the offered pay rates if the rates were attractive or benefited them. Since eligible personnel did not volunteer in adequate numbers for the offered pay, then it was not attractive or beneficial to the draftees. Potential recruits had better options for employment or use of their time. Therefore, draftees paid a penalty or "tax" by being drafted. This tax is said to consist of the difference between the provided pay and their perceived or actual benefit received from some other activity or employment. The government actually saves money for all other taxpayers by keeping wages low and drafting individuals to fill inadequately compensated positions. Draftees pay the societal tax with their labor. (Amacher et al., 1973) The Gates Commission noted the inequity of this system and

concluded that the cost of the military should be borne by all taxpayers, not just a select few who were unable to avoid the draft.

The draft had enabled Congress to keep draftee wages considerably lower than those paid competitively in the market place. Congress had legislative authority to fill manpower needs and did not worry about competitive wage problems. As discussed above, these low wages resulted in the tax-in-kind and "true" volunteer rates of around 35 percent. While it is recognized that individuals do not volunteer solely for monetary incentives, paying fairly competitive rates has assisted the armed forces in their recruiting efforts. Table 1-2 compares total military compensation (basic pay, BAQ, BAS, incentives, bonuses, and estimated fringe benefits) with comparable civilian compensation.

Table 1-2 vividly demonstrates how grossly underpaid conscripts were in 1970. The Gates Commission proposed pay increases for these junior service members to bring their compensation levels in line with that of their civilian counterparts as well as other service members. The commission recommended a pay raise of almost 50 percent for enlisted members in the first two years of service. The Gates Commission felt these raises should be made on the basis of equity alone, regardless of the decision on the transition to an AVF. Clearly, the nation was taking financial advantage of its military draftees. Melvin Laird, Secretary of Defense in 1970, argued that there was a direct correlation between the compensation provided to the service members and their retention rates. He felt that less competitive rates led to decreased retention which, in turn, adversely affected national security, the quality of life for service members, and the dignity of the armed forces. (Laird, 1980, pp. 13-15) Similarly, the Gates Commission

Table 1-2

Comparison of Compensation Profiles for Enlisted Men and a Comparable Population of Civilians, by Length of Service (1970 Pay Rates)

| Years of Service | Total Military Compensation | Total Civilian Compensation | Mil Comp divided by Civ Comp (%) |
|---|---|---|---|
| 1 | $3,251 | $5,202 | 62.5 |
| 2 | 3,935 | 5,803 | 67.8 |
| 3 | 5,275 | 6,370 | 82.8 |
| 4 | 6,249 | 6,908 | 90.5 |
| 5 | 8,516 | 7,409 | 114.9 |
| 6 | 8,151 | 7,876 | 103.5 |
| 7 | 8,741 | 8,306 | 105.2 |
| 8 | 9,125 | 8,691 | 105.0 |
| 9-10 | 9,505 | 9,065 | 104.9 |

Source: Adapted from The President's Commission on an All-Volunteer Armed Force, 1970, p. 53.

argued that competitive rates lead to increased retention and attractiveness of military service. The identification of specific raises to be recommended were dependent upon the following: the number of accessions needed each year; the number of true volunteers attracted at current levels of pay; and the extent to which raises in compensation increased the flow of volunteers.

While the impact of compensation increases were not known at the time, the feelings are obvious. To attract and retain enough volunteers to staff an AVF, compensation packages had to be competitive with those available in the

civilian sector. The program had to be beneficial and attractive to eligible personnel. The compensation paid to service members had to change in order to equitably distribute the cost of our national defense.

## D. UNIQUENESS OF MILITARY SERVICE

> ...the major difference is that members of the armed forces are legally liable to armed combat. This is their distinguishing characteristic, and whatever specialization for specific duties a member of an armed force may have is secondary to the primary function of armed combat (Military Compensation Background Papers (MCBP), 1987, p. 7).

The primary difference between military service and civilian employment involves a degree of control and impact of actions. Military service requires unique one-way control and obedience to orders. Once orders are given, there is little, if any, opportunity for internal debate. To accomplish national goals, our nation's leaders must be able to: legally require the force to fight, and be able to punish those who disobey; use the force when needed for as long as required without regard to individual preference; "fire" performers who may desire to stay and retain those who may want to leave, all for the government's convenience; force retirement for individual members and recall them to active duty as required; and hold members in an idle status for indefinite periods and then put them wherever they are needed. (5th Quadrennial Review of Military Compensation (QRMC), 1984, p. I-4)

Such limitations require total dedication on the part of the individuals who serve in the armed forces. They must relinquish personal control to the government over the following: exposure to the risks of combat; relocation of themselves and/or their families; work requirements on

holidays, weekends, and overtime; family separations; and exposure to conditions and hazards of field duty. (5th QRMC, 1984, p. I-5)

Forfeiture of these individual rights to the military institution drives many normal, patriotic Americans away from military service. These are not the only rights or elements of personal control that service members have to relinquish. For example, military personnel cannot "quit" when they desire, since most serve under fixed contracts or obligations. If the member does not fall victim to a forced retirement or separation, he or she still must continue to progress up a pyramidal promotion structure. There is no provision to allow career service members to stay in a job, at a given rank, for extended portions of their career. If not selected to progress, separation or retirement is mandatory. Even if selected to progress, careers in the military are short-lived, as retirement is mandatory between twenty and thirty years of service. Because of these conditions, "military leaders have gone to great lengths to create a professional identity--literally a different way of life in which cohesion, unity of purpose, and reciprocal loyalty are emphasized." (Binkin and Kyriakopoulos, 1981, pp. 21-22)

These job-related factors comprise the negative side of the so-called "X-factor." The X-factor is the nonquantifiable part of military life that makes it unique when compared with civilian life. How to compensate individuals for the hardships imposed is a recurring debate in military compensation battles. (GAO/NSIAD-86-11, 1986, pp. 53-56) Military life requires a special blend of commitment, obedience, and sacrifice to succeed. Millions of Americans over the years have accepted these requirements; some willingly, others unwillingly. The pressures and hazards of this "way of life" make it unique

among professions in the world. Despite difficulty in quantification, the X-factor is an integral element in determining military compensation.

# II. DEVELOPMENT OF MILITARY COMPENSATION, 1973-1993

The 7th QRMC states that "the purpose of the military compensation system, like any compensation system, is to attract, retain, and motivate people." (7th QRMC, 1992, p. 16) As this quote indicates, all compensation systems have the same basic goals and functions. As Richard Henderson observes in his book, Compensation Management, "the compensation system results from the allocation, conversion, and transfer of the income of an organization to its employees for their monetary and in-kind claims on goods and services." (Henderson, 1989, p. 2) This definition applies equally to military or civilian compensation programs. For the U.S. military, the "income of an organization" is the income generated by the government through taxes or other revenue mechanisms. "Monetary" claims refer to regular pay entitlement and "in-kind claims" to housing, messing, and other similar entitlements provided for the military. Compensation deficiencies are continually addressed and modified as the system continues to evolve. The current system developed through almost annual modifications to original programs or implementation of new ones. The development of the military compensation package was perhaps best described by Cooper in Military Manpower and the All-Volunteer Force:

> Today's compensation system is not...the result of a well structured approach designed to provide an equitable, but cost-effective compensation package. Instead it is the result of a piecemeal approach whereby the addition and deletion of specific compensation elements have generally been argued more in terms of maintaining military benefits or implementing minor cost savings (Cooper, 1977, pp. 361-363).

This chapter concentrates on where the AVF compensation system started and changes that brought us to our present situation.

## A. CHANGES IN REGULAR MILITARY COMPENSATION

The largest component of military compensation is basic pay. Basic pay is the primary method by which military members are compensated for their service. However, basic pay is not the only pay or allowance used to determine appropriate pay increases. The main tool of compensation comparison is regular military compensation or RMC. Regular military compensation comprises basic pay, basic allowance for quarters or BAQ, basic allowance for subsistence or BAS, and the tax advantage of the nontaxable allowances. (Cooper, 1977, p. 361) The term, RMC, was first introduced in the Military Pay Act of 1965, and has evolved into a comprehensible measure that serves as the basis of comparison between military and civilian pay. (Binkin and Kyriakopoulos, 1981, pp. 15-17) Regular military compensation was expanded in 1980, by Public Law 96-579, to include variable housing allowance (VHA) and overseas housing allowance (OHA). (GAO/NSIAD-84-41, 1984, p. 6) The list of pays and allowances in Appendix A highlights the complexity of the compensation system. None of the listed special or incentive pays is disbursed to a large enough population to warrant inclusion in a model for pay increases. However, every service member rates all components of RMC; thus, RMC is used as the yardstick for compensation considerations.

Throughout the first twenty years of the AVF, there was almost continual debate in the Congress over pay increases and the implementation of automatic adjustment mechanisms. Tensions often flaired as the nation's leaders came to

recognize that "competitive pay is the lifeblood of an all-volunteer force." (Philpott, September 27, 1993, p. 15) Because the AVF is forced to compete with private employers and colleges for eligible men and women, compensation incentives are vital for recruitment and retention. While it is recognized that individuals do often enlist or reenlist for purposes other than money, it is apparent that

> ...military pay would be most effective and efficient as a recruitment and retention tool if maintained over time at a level predictably attractive compared with civilian employment opportunities (7th QRMC, 1992, p. 109).

The key problems center on how to determine if pay raises are required, whom to measure pay rates against, and how to apply adjustments once they are given. These concerns resulted in numerous legislative acts that have affected the implementation and course of the AVF.

The first major law that influenced the AVF compensation system was Public Law 90-207 (Act of December 16, 1967). Prior to enactment of Public Law 90-207, commonly called the Rivers Amendment, basic pay increases occurred solely at the discretion of the Congress. They were erratic and irregular with no discernable pattern. In fact, enlisted members with less than two years of service were not included in pay raises granted to other service members in 1955, 1958, 1963, and 1964. This law was the first attempt to regulate pay increases for the military. It provided that whenever the federal General Schedule (GS) employees received a raise based upon white collar salaries, as measured by the annual survey of Professional, Administrative, Technical and Clerical (PATC) workers, the military would receive a comparable increase in RMC. Although the comparable raise was tied to RMC, the entire raise was given in basic pay alone. This procedure required

the government to provide larger basic pay increases to the military services than those provided to the federal civilian sector, since basic pay accounted for only 75 percent of RMC.

Although Public Law 90-207 tied military pay raises automatically to pay raises for civil service workers, until the enactment of Public Law 91-656 (Federal Pay Comparability Act of 1970), there was no automatic pay adjustment for civilians either. This law stipulated that GS rates be measured annually against comparable civilian sector jobs. The President was required to ensure comparability through executive order by October 1st of each year. Combined with the previous provisions of 1967, this law created the first truly "automatic" adjustments to military pay. (MCBP, 1987, p. 27)

By 1974, the AVF was fully implemented. Pay increases were still tied to RMC, but only applied to basic pay. This system was not ideal because: 1) inflating basic pay had a corresponding impact on special and incentive (S&I) pays tied to basic pay; 2) not increasing BAQ and BAS tended to diminish the effect of a pay raise in combatting expenses in those areas; and 3) tax consequences required larger basic pay increases than what would be required if some increase were applied to the nontaxable allowances. (MCBP, 1987, pp. 27-28) Because of these conditions, the method of applying all of the pay raise only to basic pay was eliminated in Public Law 93-419 (Act of September 19, 1974) in favor of applying the pay rate percentage equally across the board to all three components of RMC (i.e., basic pay, BAQ, and BAS).

In 1977, Public Law 94-361 (DoD Appropriation Act of 1977) further changed the provisions of the automatic adjustment by allowing the President to change the way pay increases were applied. Public Law 93-419 had required that pay increases occur in the same percentage for each of the

three RMC components. The new law permitted the total increase to be applied among the three components at different percentage rates, provided it was "in the best interest of the Government."

Public Law 96-342 (DoD Authorization Act of 1981) further changed the provisions of the automatic pay adjustment. There were two main effects of this law on pay: 1) it suspended the tie imposed by Public Law 91-566 between the civilian sector and military pay raises; and 2) it allowed the President to distribute the basic pay increase by military pay grade and years-of-service. These changes were made to enhance the pay for "career" personnel and to offer a larger pay increase than that provided for civilians. This suspension of automatic pay provisions was the first of many. Every year from 1983 until 1991, the automatic adjustment mechanisms were bypassed for special pay increases. Virtually every year, Congress cited budget considerations or problems with the automatic adjustment mechanisms. Several times in the early 1980s, Congress suggested that a new index be developed for more accurate comparability projections. (MCBP, 1991, pp. 35-36)

The final major act affecting the AVF compensation adjustment mechanism was Public Law 101-159 (Federal Employees Pay Comparability Act of 1990). This 1990 act linked GS civilian pay increases with the Employment Cost Index (ECI). The ECI is a measure of civilian labor costs as measured by the Bureau of Labor Statistics. Public Law 101-159 required that GS pay increases be equal to the cost increases set by the ECI. The law applied, in language, only to civilian pay. However, the linkage between civilian and military pay established in 1967 created a military benefit as well. The ECI has three advantages for the military over the previously-employed PATC survey. Initially, as Table 2-1 indicates, it is more reflective of

the military and of the broader U.S. economy. Secondly, it is widely accepted by labor economists and compensation specialists as a relatively accurate indicator of changes in the labor market. (7th QRMC, 1992, p. 113) Finally, the PATC, as suggested by the title, concentrates primarily on

Table 2-1

Comparison of PATC and ECI Indexes

| Coverage | PATC | ECI |
|---|---|---|
| Military Jobs | | |
| -Enlisted | 10% | 71% |
| -Officer | 50% | 67% |
| Total | 12% | 70% |
| Civilian Workers | 2 Million | 88 Million |
| Civilian Occupations | 23 | 417 |
| Collection Frequency | Annual | Quarterly |

Source: From Military Manpower Task Force; A Report to the President on the Status and Prospects of the All-Volunteer Force, 1982, p. IV-3.

white-collar occupations. As Table 2-1 shows, the PATC actually covered only 12 percent of military occupations.

Pay adjustments are still linked to the ECI, though a 1992 study by the RAND Corporation has questioned continued use of the index to adjust military pay. Table 2-2

highlights some of the problems cited by RAND in its report. The disparities are obvious. The ECI was developed in the early 1970s as "an indicator of changes in employers' labor costs." (Department of Labor, 1990, p. 1) It was not designed for comparisons between the military and civilian job markets. The demographics of a younger military

Table 2-2

Comparison of Percentage Surveyed by ECI and the Military Composition of Selected Demographic Categories

| Category | Military | ECI |
|---|---|---|
| Age 26 or younger | 55 | 22 |
| Age 42 or older | 5 | 33 |
| College degree or some college education | 20 | 43 |

Source: Adapted from Tom Philpott, "The Science of Measuring Pay," Air Force Times, September 23, 1993, p. 16.

population do not fit into the ECI survey analysis. Although superior to the previously-employed PATC, the ECI still does not encompass the military's demographics. In response to this disparity, RAND and the 7th QRMC Committee proposed a new Defense Employment Cost Index (DECI) to better compare civilian and military pay increases. (7th QRMC, 1992, p. 113) As of 1994, the DECI was still under review and not applicable to this study. However, it is clear that the ECI is deficient in comparing military compensation rates with civilian occupations. Throughout the years of the AVF, each of the automatic adjustment

mechanisms have had considerable impact on the largest component of RMC, basic pay. From the beginning of the AVF, the automatic adjustment mechanism has been used to attempt to maintain military pay at appropriate levels.

Based upon recommendations of the Gates Commission, Congress approved a 14.2 percent pay raise for the military on November 14, 1971. After this raise, "the 1972 annual report submitted to Congress...on the adequacy of military pay and allowances stated [the pay increase had] 'raised military pay to reasonably competitive levels for the first time in recent history'...." (MCBP, 1987, p. 35) Table 2-3 contains data on the cumulative effect of annual pay raises and cumulative increases in the Consumer Price Index (CPI), against which pay increases were being measured. The table clearly illustrates a problem with the ability of RMC to keep pace with inflationary price increases. For example, in October 1979, the military received a pay increase of 7 percent. The cumulative effect of pay increases from October 1972 until October 1979 totalled 59.6 percent. However, over that same period, the cumulative increase in the CPI was 81.5 percent. A comparison of the two measures shows that RMC lagged behind CPI by 21.9 percentage points over the sample period.

Gaps of up to 45.9 percent in the late 1970s and early 1980s contributed to problems in personnel retention during that period. By FY 1979, all services had also missed their recruiting goals for the first time since implementation of the AVF. The exodus of career personnel combined with recruiting problems "led to a reduced readiness posture in all services." (Grosz, 1983, p. 10) The pay raises of 1981 and 1982, combined with the President's authorization to redistribute pay increases under the DoD Authorization Act of 1981, assisted in bringing career retention rates back to

Table 2-3

Comparison of Percentage Increases in RMC and CPI, 1971-1991

| Effective Date | Average Total RMC Increase (Percent) | Cumulative Increase in RMC (Percent) | Cumulative Increase in CPI (Percent) | Percentage Difference (RMC-CPI) |
|---|---|---|---|---|
| Nov 1971 | 14.2 | - | - | - |
| Jan 1972 | 5.4 | - | - | - |
| Oct 1972 | 6.0 | 6.0 | 2.5 | 3.5 |
| Oct 1973 | 7.3 | 13.7 | 10.1 | 3.6 |
| Oct 1974 | 5.5 | 20.0 | 23.3 | -3.3 |
| Oct 1975 | 5.0 | 26.0 | 32.9 | -6.9 |
| Oct 1976 | 4.8 | 32.0 | 40.2 | -8.2 |
| Oct 1977 | 7.1 | 41.4 | 49.5 | -8.1 |
| Oct 1978 | 5.5 | 49.2 | 61.9 | -12.7 |
| Oct 1979 | 7.0 | 59.6 | 81.5 | -21.9 |
| Oct 1980 | 12.7 | 78.3 | 104.5 | -26.2 |
| Oct 1981 | 14.3 | 103.8 | 127.0 | -23.2 |
| Oct 1982 | 4.0 | 112.0 | 138.4 | -26.4 |
| Jan 1984 | 4.0 | 120.5 | 145.3 | -24.8 |
| Jan 1985 | 4.0 | 129.3 | 156.6 | -27.3 |
| Oct 1985 | 3.0 | 136.1 | 163.8 | -27.7 |
| Jan 1987 | 3.0 | 143.2 | 168.5 | -25.3 |
| Jan 1988 | 2.0 | 148.1 | 180.2 | -32.1 |
| Jan 1989 | 4.1 | 158.3 | 191.9 | -33.6 |
| Jan 1990 | 3.6 | 167.6 | 205.5 | -37.9 |
| Jan 1991 | 4.1 | 178.5 | 224.4 | -45.9 |

Source: Adapted from Military Compensation Background Papers, 1991, p. 43.

acceptable levels. Table 2-4 illustrates the changes in career retention rates.

Basic pay rates were not only tied to retention, but to recruiting as well. A 1978 study conducted for the Office of the Secretary of Defense (OSD) found a positive pay elasticity between pay increases and high-quality recruits. The study concluded that a 10 percent increase in pay led to a 5-10 percent increase in the quality of recruits, as determined by educational level, aptitude test scores, and the incidence of disciplinary violations. (DoD, 1978, pp. 3,56) An increase in recruit quality is an anticipated effect of the AVF. David Henderson felt the AVF could result in higher quality since it relies on and rewards individuals on the basis of self-selection. (Henderson, 1988, p. 25) In fact, the early statistics from the AVF supported his contention. The OSD report stated that while the draft forces had contained 5 percent more accessions in Armed Forces Qualification Test (AFQT) categories I and II, they had also contained three times as many AFQT category IV recruits. (DoD, 1978, p. 166)

By 1990, pay raises were no longer tied to the PATC survey but rather to the ECI for reasons previously discussed. The pay gap continued to be measured against the CPI as indicated in Table 2-3. Pay increases were also measured against the ECI, and by the early 1990s the gap according to this measure had grown to 11.8 percent. (Philpott, September 27, 1993, p. 14) Despite the large pay differential witnessed through the CPI and smaller, yet persistent, ECI gaps, the armed forces did not experience the substantial departure of personnel that occurred in the late 1970s. In fact, a massive force drawdown was initiated as the Cold War ended and the Nation sought to achieve a "peace dividend." To encourage voluntary departures of military personnel, Congress enacted a number of

incentives, namely the Voluntary Separation Incentive (VSI) and the Selective Separation Bonus (SSB). The military also resorted to forced retirements through Selective Early Retirement Boards and other means of separating personnel in the attempt to meet drawdown requirements. Military leaders were placed in a difficult position--defending increases in compensation to recruit and retain high-quality personnel while simultaneously seeking monetary incentive programs that would entice service members to leave the armed forces. An inevitable question was raised: "If military compensation is so bad, why are people not leaving?" (Philpott, September 27, 1993, p. 14) This situation focused attention on the

Table 2-4

DoD Reenlistment Rates (Percent) by Category, FY 1973-1982

| Category | 1973 | 1975 | 1978 | 1979 | 1980 | 1981 | 1982 |
|---|---|---|---|---|---|---|---|
| First-term | 24 | 37 | 37 | 37 | 39 | 43 | 52 |
| Career | 83 | 81 | 71 | 68 | 70 | 76 | 82 |

Source: From Military Manpower Task Force: A Report to the President on the Status and Prospects of the All-Volunteer Force, 1982, p. III-3.

use of automatic adjustments to military pay. Are military members truly underpaid as suggested by the adjustment indexes, or is there some element of compensation that has been overlooked? The impact of the automatic pay adjustment was not limited to basic pay alone. The effects of the adjustment were reflected in the second largest component of RMC, allowances, as well.

The military compensation system has a unique feature not found in civilian systems, namely allowances.

Allowances result from the historical need to feed and house service members. Over the years, these allowances have shifted from the original in-kind provisions to expected and relied-upon monetary payments. Two allowances, BAS and BAQ, are summarized below as a part of RMC.

Basic allowance for subsistence is provided to alleviate the expense that service members incur to feed themselves, if not fed by the government. As stated in the Military Compensation Background Papers, "...both officer and enlisted subsistence allowances were at first intended to be a cash equivalent of the approximate raw food cost to the Government of feeding its military personnel." (MCBP, 1991, p. 107) The allowance was first established in 1949 with the Career Compensation Act and has remained in effect with few changes. The 7th QRMC identified three problems with the BAS system.

Initially, BAS is not related to the cost of food, which is in direct conflict with the intended purpose. The problem centers on the automatic mechanisms used to adjust pay. Initially, no adjustments were made to the BAS allowance. In 1974, Public Law 93-419 changed adjustment procedures to permit equal applications of pay increases to all components of RMC. Increases were then applied to BAS based upon labor cost surveys, not on food cost surveys. Secondly, the system is not equitable. Fiscal 1991 provides a good example. The daily food cost to feed a member that year was $4.90. Therefore, the in-kind value to those service members provided subsistence was $4.90 per day. However, the most common BAS rate in 1991 was $6.15 for enlisted personnel and $4.30 for officers per day. Enlisted members were consequently being paid BAS, on average, in excess of the daily cost-to-feed and more than their counterparts eating in the chow hall. Conversely, officers were being paid less, on average, in both situations.

Additionally, officers have to pay a surcharge to subsist in the chow halls, which further erodes their allowance. At the same time, enlisted personnel who rate BAS must forfeit their allowance under certain situations, such as war or field duty--which removes anticipated money from their families and may cause domestic financial problems. This example of inconsistency in applying BAS raises another issue, namely that the system is too complex, with too many different rates and entitlements, to ensure proper understanding and equity. (7th QRMC, 1992, pp. 61-63)

A similar allowance provided for the cost of quarters is BAQ. Basic allowance for quarters is designed to provide monetary compensation for service members to obtain housing in the civilian market, if not provided housing by the government. The history of housing entitlements dates back to the origin of the military. However, the basic structure of BAQ was set with the Career Compensation Act of 1949. This allowance has suffered many of the same problems as BAS in relation to the automatic adjustment mechanisms. But, BAQ has one major advantage. The Military Personnel and Compensation Amendments of 1980 to Public Law 96-343 created the VHA, or Variable Housing Allowance, which compensates for housing costs in different areas. The VHA is reviewed regularly and adjusted to ensure that service members are not affected by price variations between locations. The intent is for housing allowances to be "site-neutral" and to provide service members with the same opportunities for housing regardless of duty station. (7th QRMC, 1992, p. 67)

The BAQ mechanism has worked better than BAS, but problems still exist with respect to equity. The 1991 Joint Services Housing Allowance Study found that service members have to pay 20 percent of their housing expenses from pay other than BAQ and VHA. This amounts to a 20-percent inequity for personnel who live in civilian housing as

compared with their counterparts who have government-provided quarters. (7th QRMC, 1992, p. 67) A second problem exists for junior enlisted personnel who cannot acquire adequate housing based on their entitlements. The current review mechanism places them in a vicious cycle. The VHA rates are based upon actual housing expenditures. Junior enlisted personnel can only spend the money they have, which limits their ability to acquire adequate housing. The VHA will not be raised until they spend more, but they cannot spend more until the VHA is raised. The problem is that "the current methodology for setting VHA rates does not incorporate a physical standard for adequate housing." (7th QRMC, 1992, p. 68)

## B. CHANGES IN VETERANS' ASSISTANCE PROGRAMS

Throughout the almost 50 years since World War II, Congress has enacted a series of programs to assist service members in their return to civilian life. The nation recognized that integrating veterans into the societal mainstream benefitted both the country and the individual. The "GI Bill of Rights" was established after World War II for two main purposes: 1) to provide readjustment assistance to returning veterans; and 2) to compensate veterans for their "lost time" while in the military. When the draft ended in 1973, military manpower officials recognized that GI Bill benefits, especially educational assistance, were also important in attracting the voluntary service of high-quality recruits. By this time, educational benefits had thus taken on the added role of being an enlistment incentive as well as a way of assisting less-advantaged veterans with their college expenses. Thus, veterans' educational programs were established to: 1) enhance military service; 2) provide educational benefits to service

members who might not otherwise afford it; 3) assist veterans to acquire opportunities lost through military service; and 4) help those individuals who would have pursued an educational option had they not served. (MCBP, 1991, p. 633)

The value of potential educational assistance cannot be over-emphasized when recruiting for an AVF. A study by the U. S. Army Research Institute in FY 1982 found that recruits who scored in the top two categories on the AFQT enlisted primarily for college money (~35 percent) and skill training (~25 percent). (Thurman, 1986, p. 273) Approximately 60 percent of the Army's high-quality enlistees that year joined for reasons that were directly related to these programs. Other studies have validated these results on the effectiveness of assistance programs in military recruiting. A 1982 RAND study reported that the Army College Fund produced a 9-percent increase in high-quality accessions during fiscal 1981. The introduction of generous educational programs creates a dilemma for the military: although these programs are effective as recruiting incentives, their main benefits are usually used after a service member leaves the armed forces. The advantage in recruiting could thus be offset by an adverse effect on retention. (Hosek et al., 1984, p. 25) In fact, a 1991 study by Hogan, Smith, and Sylvester on the Army College Fund supports the hypothesis of adverse retention effects. (Hogan et al., 1991, pp. 338-341) This is why post-service educational benefits are also described as a "disincentive" for reenlistment.

Following in the tradition of previous "GI Bills," Public Law 89-358 (Veterans' Readjustment Benefits Act of 1966) provided educational assistance allowances for veterans of the Cold War and Southeast Asia hostilities. Entitlements were determined by the member's length of

service and character of discharge. Generally, the benefit provided up to 36 months of assistance at secondary schools, colleges, vocational schools, apprenticeships, or other on-the-job training.

Public Law 93-508 (Vietnam Veterans' Readjustment Assistance Act of 1974) extended the GI Bill until January 1, 1977. The provisions were basically the same as the previous legislation, except that entitlements were now also determined by the number of the member's dependents and the type of training the member was receiving. Assistance increased for veterans who pursued full-time programs and had dependents. The most significant aspect of this law is the definitive ending date. Many people felt the GI Bill made a significant contribution to the quality of the AVF and wanted to retain the program. General Maxwell R. Thurman, for example, stated that "with the GI Bill went smart high school graduates who gave us the quality needed to perform the Army's mission and to sustain the strong backbone of the NCO corps." (Thurman, 1986, p. 269) Although "quality" is difficult to define, statistical evidence generally supports his assertions. (Brehm, 1982, p. 154)

By 1976, Congress recognized what many other military supporters already knew--mainly "...that education incentives drew smart, college-bound or college-capable soldiers." (Thurman, 1986, p. 271) To meet this need, the GI Bill was replaced with the "Post-Vietnam Era Veterans' Educational Assistance Program" (through Public Law 94-502). Commonly called VEAP, the new program created a "contributory" benefit whereby the Government would match service member contributions on a $2 for $1 basis. The member could contribute a maximum of $2,700 and gain a return of $8,100 (when matched with a government contribution of $5,400) to use on the same basic programs

covered under the old GI Bill. Substantial increases in assistance were also made available through "kickers" for persons who enlisted in certain occupations and met other specific criteria. For example, up to $20,100 was available through various "kickers" in the Army College Fund.

Congress made no attempt to disguise the two major forces driving the creation of VEAP. First, was the budgetary concern of the assistance programs being provided. The GI Bill was costing the government about $3 billion annually and was estimated to have a steady-state cost of $1 billion per year under the AVF. The estimated cost of VEAP was far less and transferred a portion of the budgetary burden to the DoD. Second, by Congress' specific language, VEAP was expected "to promote and assist the all-volunteer military program of the United States by attracting qualified men and women to serve in the Armed Forces." (MCBP, 1987, p. 535) By most accounts, VEAP did not accomplish the latter objective. After several attempts at modification, it was finally abandoned in 1985 and replaced with the "Montgomery GI Bill."

Included in the DoD Authorization Act of 1985, Public Law 98-525 was the Veterans' Education Assistance Act of 1984, which encompassed active duty and reserve forces. The active duty program, titled "All-Volunteer Force Educational Assistance Program," is commonly referred to as the "Montgomery GI Bill," after its Congressional sponsor, Representative G. V. "Sonny" Montgomery. This is a contributory program that requires members, enlisting after June 30, 1985, to pay $100 per-month during their first year of active duty. All contributions to the program are nonrefundable, a major change from VEAP. However, the benefits are substantially superior to VEAP. Under the Montgomery GI Bill, service members can receive up to $300 per month for 36 months, or $10,800 for a $1,200

contribution. The Secretary of Defense can approve additional benefits of up to $700 per month for hard-to-fill specialties and for eligible members who reenlist for additional service.

## C. CHANGES IN SPECIAL AND INCENTIVE PAYS

Special and Incentive pays for the U.S. military date to 1791, when enlistment and reenlistment bonuses were first offered. Initially, these pays were designed to compensate service members who were exposed to more than the normal amount of hazardous conditions. Title 37, chapter 5 of the U.S. Code defines these pays by three groups: incentive, special, and bonuses. These groupings provide no real indication of the purpose of the pay. The 7th QRMC regrouped S&I pays in three categories: hazardous duty, career incentive, and skill incentive. These categories are based upon their underlying intent (i.e., to reward exposure to hazardous duty, retain members with career potential, and retain members with desirable skills). The listing is contained in Appendix B. The QRMC groupings indicate how the purpose of S&I pays have changed over the years. Instead of compensating for exposure to hazardous duty, they now "are focused on providing additional incentives to members of the armed forces to enter certain career fields that would, without those incentives, experience manning shortfalls." (MCBP, 1991, p. 147)

In 1984, the 5th QRMC studied S&I pays in great detail. With the exception of four special pays, it validated the need and effectiveness of the payments. The commission specifically cited the need to retain flexibility with S&I pays for the services to properly manage supply and demand conditions. (5th QRMC, 1984, p. VI-2) Again, in 1992, S&I payments were studied by the 7th QRMC. This time the

Commission highlighted the potential of S&I pays to manage the experience level and technical expertise of the AVF. Unfortunately, the 7th QRMC found "little evidence of coordinated service and OSD management" and concluded that the payments were managed "on an ad-hoc basis." (7th QRMC, 1992, p. 96) In fact, the average time between incentive adjustments was 6 to 10 years, with proportional adjustments of 10 to 180 percent. This neglect towards S&I pays clearly detracts from their effectiveness and flexibility in meeting labor market changes. (7th QRMC, 1992, p. 97)

One or more S&I pays are paid to 43.1 percent of active duty service members. The pays comprise 4.8 percent of total cash compensation. Combined with basic pay and allowances, S&I pays form the major components of the military compensation system. (7th QRMC, 1992, p. 95) Table 2-5 shows the six largest (by number of recipients) and best-known pays. The role of these and other S&I pays is discussed in greater detail in Chapter III, which centers on the role of labor market considerations in establishing the military compensation system.

Table 2-5

Top Six S&I Pays for Officers and Enlisted Personnel by Number of Recipients, FY 1992

| Category | Largest | 2nd | 3rd | 4th | 5th | 6th |
|---|---|---|---|---|---|---|
| Officers (164,641) | Aviation Career Incentive Pay (72,008) | Medical Officer Variable Special Pay (13,910) | Medical Officer Additional Special Pay (10,285) | Career Sea Pay (9,356) | Aviator Contin-uation Pay (7,361) | Medical Officer Certifi-cation Pay (6,406) |
| Enlisted (777,268) | Selective Reenlist-ment Bonus (260,518) | Career Sea Pay (146,240) | Certain Places Pay (103,876) | Special Duty Assignment Pay (56,574) | Enlistment Bonus (36,746) | Submarine Duty Pay (36,013) |

Source: From 7th QRMC, 1992, p. 95.

## D. LESSONS LEARNED

### 1. Wage Comparability Surveys are Inaccurate

There have been no wage comparability surveys conducted over the past twenty years that accurately reflect all the jobs of the armed forces. Initially, the PATC had too narrow a base and focused primarily on white-collar jobs. The military has a wide occupational base and is mainly blue collar. The use of the ECI appeared more reflective of the military than the PATC. It surveyed a larger segment of the population and more military jobs, but it had problems with certain demographic factors such as age and education. Finally, the unique combat requirements imposed upon all service members make accurate comparisons difficult. There is no way to quantify the so-called X-factor, or to obtain an accurate assessment of the compensatory requirements.

### 2. Automatic Wage Adjustments are Poorly Executed

Accurate, reliable, and timely pay adjustments are desirable goals for military members and their supporters because

> a clearly articulated, rational policy for making annual pay adjustments could avoid uncertainty and misunderstanding by those most affected by the decisions--the military members (7th QRMC, 1992, p. 111).

Historically, however, automatic wage adjustments have been haphazard and poorly executed. The initial and most obvious problem, as discussed above, is how to measure wage differences. If an accurate mechanism could be developed, the next problem is proper application of the adjustments to compensation components. Throughout the first twenty years of the AVF, the methodology of arbitrarily applying raises to all components of RMC was not appropriate. There were

two adverse effects of this method of wage adjustment. First, it removed the link between BAS and BAQ and their intended purposes of defraying food and housing costs,respectively. Second, it created a sense of inequity in the federal compensation system.

**3. Intent of Allowances is Good**

The intent of BAS and BAQ is good. However, the adjustment mechanisms and their inherent complexities make these allowances less effective as compensation incentives. The universal application of wage adjustments removed the connection between the allowances and the expenses they are supposed to defray. By not considering the cost of food and housing during some pay adjustments, the allowances shift with no relation to actual costs. This creates inequities within the compensation system that are difficult to overcome.

**4. Compensation Initiatives Affect Retention and Recruiting**

Compensation initiatives do affect retention and recruiting efforts. During the late 1970s, military compensation was allowed to erode. Most noticeable was the lag in relative wage rates and the replacement of the GI Bill with the less generous VEAP. Consequently, the quality of new recruits suffered and reenlistment rates plummeted. Exit surveys conducted in 1979 and 1980, for the 1982 Military Pay Adjustment Mechanism Study, "identified dissatisfaction with compensation as the single most important factor in the decision to leave the service." (Grosz, 1983, p. 10) Recognition of these economic factors and the need for both fair and competitive compensation led to major pay increases for the AVF in the early 1980s. These pay raises are credited with restoring recruit quality

and career reenlistment rates to acceptable levels. Maintaining compensation packages that are competitive with opportunities in the civilian sector will help to sustain the AVF.

**5. Educational Benefits Affect Both Recruiting and Personnel Turnover**

Post-service educational benefits are a dual-edged sword. That is, they are both an incentive for enlistment as well as a disincentive for reenlistment. These benefits encourage college-capable or "college-bound" applicants to enlist in the armed forces to obtain post-service educational assistance. Conversely, the same benefits encourage individuals to leave the military and pursue post-service education. Compensation specialists must recognize the dual nature of these programs, determine the desired impact, and tailor educational programs to enhance recruiting or retention efforts.

# III. MARKET OR INSTITUTIONAL APPROACH

From the earliest days of the AVF, there have been basically two concepts that have dominated discussions of military compensation. These are the "institutional" and "market" approaches. Military compensation has been influenced primarily by institutional considerations throughout most of American history. However, since implementation of the AVF in 1973, the military has relied primarily upon the competitive labor market to obtain military personnel. (GAO/NSIAD-86-11, 1986, pp. 6-7) The combination of institutional pay considerations in a market environment has resulted in a complex system of compensation. Some commentators, such as Charles Moskos, argue in behalf of the institutional approach, finding serious problems in methods of military compensation that are dominated by market dynamics. Proponents of each approach are equally persuasive and adamant in presenting their position. This chapter explores institutional and market concepts and their role in the AVF compensation program.

## A. INSTITUTIONAL APPROACH

This approach is based upon the concept "that members of an institution are motivated primarily by a sense of identity with an organization." (GAO/NSIAD-86-11, 1986, p. 14) Moskos defines an institution

> ...in terms of values and norms...a purpose transcending individual self-interest in favor of a higher good. Members [of the military]...are often seen as following a calling...as being different or apart from the broader society...(Moskos, 1978, p. 31).

Supporters of the institutional approach believe that military members of the AVF should feel this separation and special calling. Instead of being paid entirely in market-driven monetary wages, they should also serve for the institutional benefits of respect and for other social advantages. Their commitment is thus grounded in the institutional values of "duty," "honor," and "country"; and military service is a "way of life," not a "job." (5th QRMC, 1984, p. I-3)

Military service is based on numerous institutional concepts. The unique conditions of the X-factor, described in Chapter I, apply here. Service members are exposed to overseas tours, family separations, enlistment contracts, twenty-four-hour duty, frequent family moves, and military discipline and law. Complete submission to orders of superiors and the constant possibility of combat action heighten the member's commitment to the institution. Military service requires commitment and loyalty from *all* service members, regardless of job specialty. As noted in a 1986 GAO report, "in exchange for military personnel accepting this unlimited liability contract, military leaders believe that they have a moral and ethical responsibility to care adequately for them and their families." (GAO/NSIAD-86-11, 1986, p. 9)

Military compensation is not the result of individual expertise, but rather "a function of rank, seniority, and need." (Moskos, 1978, p. 32) The "need" factor is a basic institutionalist concept, where more is provided to those who have greater need. In fact, it is estimated that close to 40 percent of total military earnings is based on factors other than job performance. Other factors include marital and dependency status, availability of government facilities, and deferred income. (Binkin, 1975, p. 37)

Institutionalists argue that *all* service members are subject to the same national defense responsibilities. In-service occupational specialties may vary from member to member, but the expectations from the nation are essentially the same for all persons in the military. Therefore, all members of the same rank and experience should be paid the same amount for their service. This concept is the foundation of the military basic pay system. With minor exceptions, all pay raises during the years of the AVF have been applied universally to all members of the armed forces.

The military places high value on the welfare of its members and has developed a compensation system described as highly "paternalistic." (GAO/NSIAD-86-11, 1986, p. 9) That is, the compensation system includes noncash provision of food and housing or nontaxable allowances in lieu of these goods. These allowances are based on the "need" concept prevalent throughout the institutionalist philosophy. The proponents argue that, only by adequately caring for each member on the basis of individual needs, can the nation secure a committed and capable military force. The institutionalist dogma is best explained through different BAQ rates for married and single service members. Married members, on the basis of additional dependents, need a larger BAQ allowance to secure adequate accommodations for their dependents. It is believed that the needs of the single member do not require as large an allowance because single persons need to secure lodging only for themselves.

The highly paternalistic and needs-oriented nature of the institutionalist philosophy is seen to include subsidized shopping on military installations, recreational activities, health care, annual leave provisions, survivor benefits, and deferred compensation through retirement benefits, as examples. Individual service members place different values on each of these benefits, which could be

substantially higher or lower than the cost incurred by the armed forces to provide the services. However, the institutionalist philosophy prefers to provide such services for the welfare of military members and their families.

There are several advantages in the institutionalist approach to compensation. Initially, the so called X-factor, or the unusual, nonquantifiable demands of military life, has always been difficult to define and compensate. Under the institutional approach, no monetary remuneration is specifically required for this factor. There is a recognition that life is different within the armed forces; and every individual is compensated, equally and without special consideration of military demands, for his or her commitment to the organization.

Moreover, institutionalists believe the compensation system should be used to enhance the relationship between the organization and the service member. Under this approach, members are supposed to gain goal commitment, increased morale, and unit cohesion. These intangibles of service apply, in both war and peace, and strengthen the overall functioning of the armed forces. The loss of commitment, morale, and cohesion could diminish combat effectiveness.

Finally, there is one basic pay scale under the institutional philosophy. All service members are recognized to have equal responsibilities to the institution. By maintaining one pay scale, it is believed that shared commitment and goal congruence can be encouraged; furthermore, equal pay ensures that equal value is placed on the commitment of each member to the nation's defense.

The institutionalist approach also has some disadvantages. As noted, the paternalistic practice of providing more benefits to married members than to single

members is a direct outgrowth of the institutionalist philosophy of "need." It is true, generally, that married members incur greater costs than do single members. However, the practice does create impressions of inequity when members with the same grade, time-in-service, and specialty, are provided different benefits strictly on the basis of dependency status. Such a system provides "unequal pay for equal work." Table 3-1 contains Binkin's demonstration of this concept. Although the analysis reflects pay in 1975, the point remains valid to this day. Institutionalists favor a compensation system that includes elements based on the need of the service member (GAO/NSIAD-86-11, 1986, p. 14), even though this may create the appearance of inequity for single members. As seen in Table 3-1, a married sergeant in the mid-1970s was compensated an additional 14.6 percent over his single counterpart.

A second major disadvantage is automatic time-in-service pay adjustments. Adjustments to the basic pay scales are made on the basis of grade and longevity. Institutionalists support longevity increases because they reward "long and faithful service." (GAO/NSIAD-86-11, 1986, p. 49) These increases are not correlated with productivity or performance. The poor and stellar performers all rate the same pay adjustments. This system has opened the compensation program to scrutiny and criticism. However, it is defended on the basis of equity and fairness across inter-Service lines. Each Service has different promotion opportunities, and institutionalists believe that military members should not be penalized if the promotion opportunities are slower in one Service as opposed to another. (GAO/NSIAD-86-11, 1986, p. 50)

Table 3-1

Comparison of Estimated Compensation in 1974 for an Unmarried and a Married Sergeant (E-5) with Four Years of Military Service, Receiving Cash Quarters and Subsistence Allowances

| Compensation Element | Unmarried Sergeant | Married Sergeant with one child |
|---|---|---|
| Regular Military Compensation | $8,778 | $9,348 |
| Basic Pay | 6,156 | 6,156 |
| Quarters Allowance | 1,174 | 1,757 |
| Subsistence Allowance | 880 | 880 |
| Tax Advantage | 568 | 555 |
| Supplemental Benefits | $0 | $715 |
| Dependent Health Care | 0 | 500 |
| Commissary | 0 | 215 |
| TOTAL | $8,778 | $10,063 |

Source: From Martin Binkin, The Military Pay Muddle, 1975, p. 38.

**B. MARKET APPROACH**

The market approach[1] to compensation management centers on the mechanisms of supply and demand in the labor market. Warner identified four distinguishing characteristics of the approach: efficiency, response to incentives, consumer preferences, and current value of compensation. (Warner, 1983, pp. 23-24)

Economists believe that a fundamental goal of the compensation system should be to obtain the correct mix of

[1]This approach has also been called the occupational or economic method.

personnel at the lowest possible cost. Therefore, the compensation system should be targeted to obtain the required number of personnel in each occupation. Different occupations have separate supply and demand elasticities that must be recognized to obtain personnel at the lowest cost. The market philosophy argues against across-the-board pay raises, which overcompensate some occupations while undercompensating others. Such raises are seen as totally inefficient and expensive in economic terms.

Proponents of the market approach contend that monetary and nonpecuniary incentives can make a difference in military enlistment and retention rates. Numerous studies have supported their beliefs.

Diversity of consumer preferences for goods and services implies that individuals do not place the same value on nonpecuniary benefits. Therefore, different service members do not necessarily gain equal benefit from these expenditures. Similarly, the government may not gain complete financial advantage for nonpecuniary benefits with respect to their cash equivalent. This condition, according to market theory, suggests that the compensation system should concentrate on cash incentives that have equal value among all members.

Warner observes that military personnel "prefer current dollars to future dollars...." (Warner, 1983, p. 24) Nothing demonstrates this observation better than the military's experience with its incentive programs for downsizing the force in the early 1990s. Military planners originally estimated that 38 percent of eligible personnel would accept the VSI (future money) buyout and that 62 percent would select the SSB (current money) option. The DoD budget for out-years was based upon these estimates. However, demonstrating the validity of this economic theory, the actual percentages were significantly different: 15

percent of personnel opted for the VSI and 85 percent took the SSB. The implication here is that the effectiveness of monetary incentives depends largely upon their perceived value in current dollars--although there were large differences in the choice of VSI or SSB by enlisted personnel and officers (with officers more likely to take the VSI).

The economic characteristics identified by Warner are applicable in labor discussions. However, labor economists recognize that the labor market can be more complicated than traditional economic markets that work exclusively on supply and demand. The conditions of employment, or nonpecuniary factors, are often more important to employment decisions for potential workers than are the offered wages. Labor economists stipulate that "...a host of institutions and pieces of legislation that influence the employment relationship do not exist in other markets." (Ehrenberg and Smith, 1991, p. 2)

Identification of labor market influences are vital to ensure adequate manning and force shaping. In fact, many of the factors that affect staffing of the armed forces are legislated by Congress and create special labor market considerations. Ehrenberg and Smith state that "when a formal set of rules and procedures guides and constrains the employment relationship *within* a firm, an *internal labor market* is said to exist." (Ehrenberg and Smith, 1991, p. 22) The armed forces have an internal labor market. An internal labor market is distinct from an external market, in that the external market is governed purely by market forces. The internal market requires filling entry positions from outside the organization, but all upper-level positions are filled from within the firm.

The concept of an internal labor market is consistent with the military's closed manpower system, previously

discussed in Chapter II. Once employed within an internal labor market, the individual is considered safe from outside competitive market forces. Furthermore, the individual has the capability to compete for promotions within the organization that are often based upon seniority and not ability. "This model [internal labor market] appears to capture many of the realities of the military personnel situation." (Roth, 1987, p. 28)

One of the earliest examples of the market approach to compensation is enlistment bonuses. The origins of enlistment bonuses or "bounties" can be traced to 1791 and the earliest efforts to raise the nation's armed forces. The first bounties were institutional in nature, as they were paid to all recruits who enlisted for service. During the Civil War, unsavory individuals perfected the art of "bounty jumping." Men would accept a bounty--and then desert, only to collect another bounty in a different state. These actions led to the termination of enlistment bonuses after the Civil War.

Public Law 92-129 (The Military Selective Service Act Amendments of 1971) revived enlistment bonuses with a new market philosophy. The new bonus program encouraged enlistment in "combat arms" for a payment of $1,500. The combat arms limitation was removed with Public Law 93-277 (The Armed Forces Enlisted Personnel Bonus Revision Act of 1974). The 1974 regulation required only that persons enlist for a period of at least four years in a "critical" field. The bonuses were provided in lump-sum payments.

Throughout the 1974-1993 period, numerous legislative acts have extended the bonus program and raised the amount of the bonuses authorized. The only other significant change to the program occurred in 1981 under Public Law 96-342 (DoD Authorization Act of 1981). This law provided that enlistment bonuses be offered with an initial partial

payment and "the remainder paid in equal periodic installments payable not less frequently than once every three months." (MCBP, 1991, p. 392)

Table 3-2 contains cost data for the enlistment bonus program from 1972-1990. Four points of interest deserve special consideration. Initially, the huge jump in numbers and cost from 1972 to 1973 reflects the end of conscription and the need for the Army and Marine Corps to fill their "combat" specialties. Second, the years 1977-1980 have previously been identified as a problem for the military, as military pay lagged against the CPI and the GI Bill was terminated. Table 3-2 indicates that there was no effort made to attract personnel to critical fields during this time through bonuses. Third, the Services made extensive use of bonuses from 1983-1986. Table 2-3 previously demonstrated that RMC continued to lose ground against the CPI during this period. However, Table 3-2 indicates that heavy use was made of this program to ensure the proper number and caliber of personnel were recruited to fill critical billets. Finally, although the total numbers and maximum authorizations have changed significantly, it can be seen in Table 3-2 that the average cost-per-individual has not significantly changed over the 19-year time period.

The 5th QRMC studied enlistment bonuses in great detail and determined that enlistment bonuses were "an appropriate managerial tool for channeling quality individuals into critically undermanned skills." (5th QRMC, 1983, p. 415) Additionally, a study of 1980 enlistment bonus recipients in the Army found that these personnel stayed in the service longer than nonrecipients by an average of 1.2 years. Thus, despite the bonus payment, recipients had a lower training cost-per-year than did non-bonus enlistees. By using bonuses to target 14,858 high-quality enlistees, the Commission consequently estimated that the Army alone saved

Table 3-2

Enlistment Bonus Costs and Number of Personnel, 1972-1990

| Fiscal Year | Total Personnel | Total Cost ($000) | Cost per Enlistment ($) |
|---|---|---|---|
| 1972 | 1,022 | 1,533 | 1,500 |
| 1973 | 27,144 | 40,917 | 1,507 |
| 1974 | 18,440 | 43,012 | 2,333 |
| 1975 | 24,099 | 58,776 | 2,439 |
| 1976 | 29,626 | 68,481 | 2,312 |
| 1977 | 14,058 | 30,295 | 2,155 |
| 1978 | 14,741 | 34,076 | 2,312 |
| 1979 | 18,280 | 42,683 | 2,335 |
| 1980 | 20,246 | 50,625 | 2,501 |
| 1981 | 25,183 | 69,370 | 2,755 |
| 1982 | 29,123 | 106,202 | 3,647 |
| 1983 | 35,031 | 122,103 | 3,486 |
| 1984 | 43,620 | 113,625 | 2,605 |
| 1985 | 44,213 | 117,838 | 2,665 |
| 1986 | 40,767 | 127,315 | 3,123 |
| 1987 | 32,810 | 87,802 | 2,676 |
| 1988 | 25,546 | 63,048 | 2,468 |
| 1989 | 25,528 | 63,450 | 2,486 |
| 1990 | 36,746 | 79,316 | 2,159 |

Source: Adapted from Military Background Compensation Papers, 1991, p. 394.

$9.3 million in training costs in 1980. (5th QRMC, 1983, p. 412)

Reenlistment bonuses, like their counterpart for enlistments, were initiated with an institutional philosophy. The first reenlistment bonuses were paid as "reenlistment bounties" in 1795 to all members reenlisting in the armed forces. The universal eligibility of all military personnel to receive a reenlistment bonus continued until 1974. The modern program is traced to the Career Compensation Act of 1949, which was based upon studies of the Hook Commission. The Hook Commission recommended, on the basis of its 1948 study, that: 1) bonuses be based upon the number of years for which a member reenlists; 2) bonuses should increase for longer reenlistments; 3) the member's reenlistment should occur to ensure continuous service; and 4) the number of bonuses a member can be paid should be limited. (MCBP, 1991, p. 398)

The Act of July 6, 1954 modified the provisions of the 1949 legislation by placing more emphasis (and monetary reward) on first reenlistments rather than subsequent career reenlistments. This set in place the provisions of the Regular Reenlistment Bonus (RRB) that survived until 1974. The program had a strong institutional base, as every member accepted for reenlistment was paid the bonus. The RRB was augmented in 1965 with a new, market-oriented program, the Variable Reenlistment Bonus (VRB). The VRB was designed to target individuals filling critical skill areas, and only first-term reenlistees were eligible. The variable bonus could be paid in addition to the regular bonus. These bonus programs were in place when the draft ended in 1973.

Both the RRB and VRB were terminated with Public Law 93-277 (Armed Forces Personnel Revision Act of 1974), which enacted the Selective Reenlistment Bonus (SRB). The SRB changed the focus of the bonus program by specifically

targeting "critical" areas for bonus eligibility. Such modification was necessary because it has been estimated that the previously employed RRB excessively paid $43 million, in 1972 and 1973, to individuals who would have reenlisted anyway or were in fields with ample manpower to fill their required billets. (MCBP, 1991, p. 399) This conflicted directly with the goal of economists to obtain the best force for the lowest possible cost.[2]

Over the years, Congress has enacted legislation to refine and improve the SRB by changing maximum bonus limits, administrative procedures, and eligibility requirements. By 1993, the program had a maximum payment ceiling of $45,000 and consisted of three eligibility zones reflecting time-in-service requirements for service members. If a service member's field is identified as critical, he or she can receive one bonus in each of the three zones. Each zone and field has an identified multiplier that is the basis for the size of the bonus. In this manner, bonuses are only paid to fill critical or difficult-to-fill billets.

Current payment procedures for the SRB combine institutionalist and market considerations by paying service members both current and future money. Fifty percent of the bonus is paid upon reenlistment, with the balance paid in equal installments over the life of the reenlistment period. Although Congress has at times authorized initial payments in excess of 50 percent, budget considerations have prevented the Services from providing larger initial payments as bonus incentives.

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[2]This is a symbolic expression that does not portray true "economic thought." Better economic representations would be to maximize defense utility while minimizing cost or obtaining maximum utility for the last dollar spent on defense.

Table 3-3 presents cost data for military personnel receiving the SRB from 1975-1990. Several points of interest in the table deserve consideration. First, the period 1977-1980 has previously been identified as a problem for pay lags against the CPI, GI Bill termination, and enlistment bonuses. Again, with reenlistment bonuses, there was no increased usage to offset force-level problems. It is readily apparent how the term "hollow force" developed during this time period. Second, throughout the 1980s, the SRB was used extensively to target and retain required service members. This is particularly obvious in 1981 and 1982. Table 2-4 demonstrated the decline in reenlistment rates for career personnel throughout the 1970s. The SRB was used extensively, in combination with basic pay increases, to stop the mass exodus of career service members. Finally, the average bonus per reenlistee offered in the late 1980s was not significantly different from that offered in the late 1970s, yet the retention results and force capabilities were significantly different during those periods.

The differences in retention and recruiting efforts during the periods highlight the overall value of the complete compensation program. Economists espouse combining a variety of programs to achieve a targeted goal of maximizing defense while minimizing cost. During the late 1970s, it appears that the focus shifted primarily to cost and many defense requirements were neglected.

The 5th QRMC studied the SRB in great detail and determined that it was a reasonably good method of force management. However, the Commission studied each zone for elasticity of reenlistments with respect to bonus payments. While acknowledging the complexity of the analyses, it arrived at different conclusions for each zone. The Commission determined "Zone A bonuses appear effective in

Table 3-3

SRB Costs and Number of Personnel, 1975-1990

| Fiscal Year | Total Personnel | Total Cost ($000) | Cost per Reenlistment |
|---|---|---|---|
| 1975 | 47,804 | 126,213 | 2,640 |
| 1976 | 49,035 | 63,939 | 1,304 |
| 1977 | 78,729 | 103,783 | 1,318 |
| 1978 | 116,955 | 149,813 | 1,281 |
| 1979 | 145,248 | 242,356 | 1,669 |
| 1980 | 115,843 | 296,300 | 2,558 |
| 1981 | 130,768 | 598,631 | 4,578 |
| 1982 | 93,895 | 490,932 | 5,229 |
| 1983 | 130,168 | 354,966 | 2,727 |
| 1984 | 186,131 | 406,574 | 2,184 |
| 1985 | 238,012 | 486,911 | 2,046 |
| 1986 | 268,005 | 554,541 | 2,069 |
| 1987 | 285,832 | 508,614 | 1,779 |
| 1988 | 272,277 | 468,336 | 1,720 |
| 1989 | 266,215 | 498,451 | 1,872 |
| 1990 | 260,518 | 484,303 | 1,859 |

Source: Adapted from Military Compensation Background Papers, 1991, p. 405.

inducing additional reenlistments"; "Zone B bonuses appear less effective than those in Zone A" but are still

effective; and the "possibility...[exists that]...Zone C changes in the bonus are currently not an effective means to induce changes in reenlistment." (5th QRMC, 1983, p. 655) A separate study by Hosek, Fernandez, and Gissmer in 1984 determined that the relationship between pay decreases and bonus increases required to maintain retention rates were pertinent and within acceptable levels. Their analysis found that an "aggressive use of the existing SRB could blunt the effects of declining pay and unemployment on retention in critical skills." (Hosek et al., 1984, p. 29)

To this point, the discussion of market applications has centered on bonus payments. However, there is another aspect of this approach that has had a major impact on the military compensation system. The 7th QRMC identified three basic components of a "flexible, efficient military compensation system." They were basic pay, allowances, and S&I pays. (7th QRMC, 1992, p. 95) The institutional nature of basic pay and allowances has been previously discussed in this chapter. Special and incentive pays are the only part of the Commission's "big three" that is based upon the market philosophy. The earliest S&I pay, career sea pay, was initiated in 1835, and various S&I pays have been incorporated since (see Appendix B). The original intent of the pays was to compensate individuals for exposure to excessively hazardous conditions. Nevertheless, over the years, S&I pays have evolved to represent a modern, economic function. That is,

> ...today most special and incentive pays are focused more on providing additional incentives to members of the armed forces to enter into certain career fields that would, without those incentives, experience manning shortfalls (MCBP 1991, p. 147).

Regular military compensation serves as the basis of comparability between military and civilian wages. Special and incentive pays are used to augment RMC and to ensure that military wages remain competitive with civilian wages in critical fields where the average civilian wage is considerably above RMC levels. This procedure is used in place of individual wage scales for separate military occupations. Table 3-4 shows the impact of S&I pays on the entire force. While S&I pays account for about 5 percent of the total DoD cash compensation, 43 percent of all military personnel receive one or more S&I pays.

Table 3-4

S&I Pay Data by Service, 1992

| Category | DoD | USA | USN | USMC | USAF | USCG |
|---|---|---|---|---|---|---|
| S&I pays as a percentage of total cash compensation | 5 | 3 | 8 | 3 | 4 | 3 |
| Percentage of the force drawing S&I pays | 43 | 33 | 71 | 29 | 33 | 40 |

Source: From 7th QRMC, Major Topical Summary (MTS)-4, 1992, pp. 4-5.

A major concern has always been to maintain proper balance between various incentive pays. Regular and consistent analysis of incentive pays, short-term bonuses, manpower requirements, and labor market conditions are required to ensure that proper balance is maintained. Unfortunately, the previously described difficulties of maintaining RMC are equally applicable to S&I pays. The 7th QRMC found that there is an "absence of a consistent and

effective method for reviewing and adjusting incentive pays." (7th QRMC (MTS-4), 1992, p. 4-3) Table 3-5 contains data on the cumulative changes in the five largest incentive pays (based upon number of recipients). The table uses 1974 as the base year and demonstrates a consistent lack of attention to these five pays, as compared with the regular adjustments provided to elements of RMC. As previously noted, the average adjustment to S&I pays occurred after 6 to 10 years, with proportional adjustments of 10 to 180 percent. Proper attention and balance must be maintained to ensure force maintenance.

The market approach allows for the specific targeting of the military's personnel needs and the development of compensation systems to address those needs. For example, if reenlistment efforts are proceeding without difficulty, then the SRB can be reduced or eliminated. If initial enlistments are a problem, then specific bonuses or incentives can be implemented to attract the required personnel to fill the Services' needs.

The evidence is clear--the military can be staffed at lower cost by targeting compensation incentives specifically where they are needed and to individuals who place value on the incentives. The equal spreading of compensation incentives to all service members is inefficient and wasted on those members who do not value the entitlement. The "cafeteria" style of benefits and services can be both flexible and efficient. The cafeteria style grew out of the recognition that individuals have different needs and do not place equal value on equal entitlements. Market proponents recognize this fact and argue against the paternalistic practice of providing universal benefits and services for all members. Indeed, one company that implemented a cafeteria style plan reported that only 10 percent of its employees selected the same benefits offered under the

Table 3-5

Cumulative Percentage Change in Incentive Pays Since 1974, by Fiscal Year, 1974-1991

| FY | Basic Pay | BAQ | BAS | Career Sea Pay | Special Duty Assignment Pay | Aviation Career | Submarine Duty | Medical Officers Variable Special |
|---|---|---|---|---|---|---|---|---|
| 1974 | 100 | 100 | 100 | 100 | 100 | 100 | 100 | -- |
| 1975 | 105 | 105 | 105 | | | | | |
| 1976 | 109 | 116 | 110 | | | | | |
| 1977 | 116 | 129 | 118 | | | | | |
| 1978 | 122 | 136 | 124 | | | | | |
| 1979 | 130 | 146 | 133 | X | | | | |
| 1980 | 130 | 146 | 146 | | | 125 | 110 | 100 |
| 1981 | 146 | 163 | 163 | | | | | |
| 1982 | 167 | 186 | 187 | 162 | | 154 | | |
| 1983 | 173 | 193 | 194 | | | | | |
| 1984 | 173 | 193 | 194 | | | | | |
| 1985 | 180 | 201 | 202 | X | 183 | | | |
| 1986 | 187 | 209 | 210 | | | | | |
| 1987 | 193 | 215 | 216 | | | | | |
| 1988 | 199 | 222 | 223 | X | | | 150 | |
| 1989 | 203 | 226 | 227 | | | | | |
| 1990 | 211 | 242 | 237 | | | 190 | | 130 |
| 1991 | 219 | 251 | 245 | | | | | |

Notes: 1) "X" denotes increases for certain grades;; and 2) 1974 or Starting Year = 100

Source: From 7th QRMC (MTS-4), 1992, p. 4-4.

firm's old program (Ehrenberg and Smith, 1991, p. 403). The Services could gain several benefits from efficient application of incentives, including: 1) cost containment; 2) provision of benefits desired and valued most by employees; and 3) the opportunity for employees to express their value on available benefits. (Henderson, 1989, pp. 452-453) Providing benefits valued by service members will enhance the military compensation package.

The market approach places high value on current cash compensation initiatives. If the institutional approaches of subsidized and deferred benefits and separate housing and food allowances were abandoned in favor of a combined payment, i.e., through a salary system, the system would become much simpler and easier to manage. Of course, new methods of adjustment would be required to evaluate such a system. This market force does affect the military compensation system, but it conflicts with the consequences of an internal labor market.

The military's internal labor market encourages service members to remain on active duty through the ability to compete for promotional positions. The fact that the personnel system is closed and all hiring is done from within the force leads to career aspirations for large numbers of service personnel. Service members entering the armed forces with career desires are more concerned with the present value of their career earnings, as opposed to the initial wages paid. (Ehrenberg and Smith, 1991, pp. 420-421) Another advantage of the internal labor market is the ability to keep hiring costs low. Because the military only hires at the entry level (E-1 or O-1), it is able to keep its entry wages relatively low. Low entry wages come with the understanding that if the individual is selected for promotion, his or her potential for career earnings is comparable with competing sources of employment.

An internal labor market can save additional hiring costs because it allows the armed forces to observe workers on the job and select the best performers. By permitting on-the-job evaluations, the military can make better personnel decisions. (Ehrenberg and Smith, 1991, p. 168) This aspect of labor economics is congruent with the institutional desire to build a professional, highly-capable career force.

A major advantage of the market approach becomes a disadvantage when considered in the context of an internal labor market. That is, the market approach relies on supply and demand to establish wage rates in the labor market. However, an internal labor market removes the competitive nature of the market from those forces acting on labor supply and demand. Since the military only hires (promotes) career personnel from within its ranks, the competition from outside sources is essentially removed. While it remains necessary to take account of the opportunity cost of military personnel, to achieve the desired shape for the force the true cost savings that the market approach theorizes may not be attainable in an internal market.

Additionally, the market system is extremely complex. For example, maintenance of S&I pays and bonuses for enlistment and reenlistment in critical fields makes a market-driven compensation program difficult to manage. In addition, developing and maintaining individual pay charts for military occupations reinforces the complexity of the system.

A market system does not consider the basic organizational requirements of shared responsibility for the defense of the nation. Instead, it concentrates solely on each individual's job skills. There is a certain amount of shared responsibility and hardship prevalent throughout the armed forces that builds comraderie and esprit. A

market-driven system of separate pay scales for members of the same grade in different job specialties could adversely affect the armed forces by creating morale problems through appearances of inequity.

During a major, prolonged conflict on the scale of World War I or II, the market approach could also be very expensive. As Henderson has observed, "voluntarism depends to some extent on patriotism. If people are not patriotic, then they must be paid more to join than if they were patriotic." (Henderson, 1988, p. 29) A war's popularity and its impact on national patriotism could adversely affect recruiting efforts. Relying on the labor market's supply and demand to meet manpower requirements could become very expensive during periods of unpopular military activities. Demand would obviously rise while supply would at the least remain the same, if not decrease. In either scenario, the costs of recruiting new enlistees could be expected to rise substantially. This would be particularly distressing to organizations, such as the military, that only hire at the entry level. Of course, any prolonged conflict on the scale of a world war would likely lead to the reinstitution of military conscription.

Just as bonuses are flexible, S&I pays are inflexible. The rates are set by Congress and are not open to Service discretion, as are bonuses. The constant need for monitoring and maintenance, coupled with the lack of the same, have made these pays an important, yet neglected, tool for force-level maintenance.

## C. COMPARISON OF INSTITUTIONAL AND MARKET APPROACHES

Table 3-6 summarizes the basic philosophical differences between the institutional and market approaches to military compensation.

Table 3-6

Comparison of Institutional and Market Approaches to Military Compensation

| Category | Institutional Approach | Market Approach |
|---|---|---|
| Philosophy | Equal pay for equal responsibility | Equal pay for equal work |
| Pay Purpose | Enhance relationship between the individual and organization | Obtain best force at the lowest possible cost |
| Framework | Intangibles such as, cohesion, honor commitment | Supply and demand |
| Pay | Paternalistic; deferred income and in-kind payments | Individualistic; current income and personal preference |
| Allowances | Based upon service member's needs | Based upon equality of pay |
| Employment Basis | Member's role is to defend the nation | Member's role is skill-based |
| Pay Adjustments | Uniformly applied to all service members | Applied only to critical occupations |

## D. LESSONS LEARNED

### 1. Compensation System is Equitable

The nation has blended diverging philosophies to form an equitable compensation system for the armed forces. A

single basic pay scale, with universal pay adjustments, has contributed to a sense of equality and esprit among military members. Similarly, despite periodic protests of inequity, the multiple allowance rates based upon need are also equitable. This conclusion is underscored by the continuing success of the AVF. If the system were grossly unfair and inadequate, military personnel would undoubtedly "express their dissatisfaction by 'voting with their feet' and leaving the service." (Grosz, 1983, p. 11)

**2. Bonuses are Efficient and Flexible**

Enlistment and selective reenlistment bonuses are efficient methods to fill critical billets. By applying a purely market approach to the military compensation system, the armed forces have been able to target, attract, and retain personnel to meet their qualitative and quantitative needs in critical areas.

**3. S&I Pays are Vital for Force Management**

Special and incentive pays are vital components of force compensation management. S&I pays enable the nation to provide an acceptable compensation level to obtain the majority of the required force and target extra compensation to essential personnel. The fact is, 43 percent of military personnel receive at least one type of S&I pay. If the armed forces could provide only basic pay to attract the military force, the pay would have to be set high enough to attract the 43 percent that are paid special pays. Setting the base pay that high would result in overpaying the remaining 57 percent of the force that would have enlisted at the lower rates. The S&I mechanism provides a lower overall manpower cost by targeting specific occupations for retention.

**4. S&I Pays Should be Updated Regularly**

The importance of S&I pays requires that they be evaluated and adjusted on a regular basis. The majority of military personnel are under contracts and active duty service obligations; therefore, problems may not be seen immediately. The discontent in critical specialties created by allowing S&I pays to lag could create long-term problems for short-term gains. To maintain force readiness, the military needs to maintain a proper mix of military manpower. Every S&I pay used to maintain the armed forces must be evaluated and updated *regularly*. The fact that incentive pays have been allowed to stagnate an average of 6 to 10 years, and then be adjusted up to 180 percent, is unacceptable.

**5. Institutional and Market Practices are Vital**

A purely institutional or a purely market approach would not provide a satisfactory system of military compensation. Each approach has strengths and weaknesses, as discussed in this chapter. The current system of military compensation is not perfect, but it has successfully blended the major advantages of each approach into one comprehensive package.

**6. The Internal Labor Market is Consistent with Institutional Strategies**

The closed manpower system of the military services is congruent with an internal labor market. The internal labor market has several key features that are consistent with institutional philosophies. For example, it encourages career considerations; it emphasizes the present value of career earnings over initial wage rates; and it requires the payment of wages comparable with competing employment sources over the member's career.

# IV. STANDARDIZED APPROACH TO MILITARY COMPENSATION

The compensation system of the AVF is not guided by a formal set of principles or guidelines (7th QRMC, 1992, p. 151). Numerous studies over the years have recommended the enactment or adoption of standard principles to guide military compensation decisions; however, despite these efforts, legislative adjustments often vary with respect to their method and intent. This fact was illustrated when President Ronald Reagan stated, in his activation letter of the 5th QRMC (1982), that "a coherent and logical statement of principles and concepts of military compensation in relation to national security objectives should be required...." (5th QRMC, 1984, p. A-1) As discussed in earlier chapters, there are numerous legislative requirements that provide limited guidelines for military compensation. However, no formal philosophy or set of principles has been established. Automatic pay adjustments may be the closest that military compensation has come to a formal guide.

Earlier in Chapter II, a detailed discussion was provided on the development of procedures for automatic pay adjustments. The automatic pay adjustments are closely linked to the principle of pay comparability. Pay comparability with the civilian sector is recognized as a major goal of military supporters and numerous legislators. However, there are competing principles, such as pay competitiveness, that deserve equal consideration. Although automatic pay adjustment procedures have been instituted, there has been some concern over the effects of pay comparability on the institutional nature of the armed forces. The issue of compensation principles has been

analyzed by numerous groups and agencies, such as the QRMC, GAO, Defense Manpower Commission (DMC), and DoD. Each has presented ideas on the development of standardized principles to guide military compensation.

In 1986, GAO identified the following potential benefits of compensation principles: 1) they define a policy for military compensation; 2) they provide a framework to evaluate and change the compensation system; 3) they provide a reference point to judge the consistency of compensation adjustments; 4) they bring stability to the compensation system; and 5) they help service members understand the rationale for periodic changes. (GAO/NSIAD-86-11, 1986, p. 21) Development of pay standards, regardless of their methodology, would ensure review in a standard, established method. The compensation system would not be subject to sporadic, irregular review and revision. As Air Force Lieutenant General Benjamin O. Davis, Jr. has stated, "without an agreed-upon standard, there can be no consistency in the necessary periodic reviews of the adequacy of military pay and benefits." (Report of the President's Commission on Military Compensation, 1978, p. 185)

This chapter concentrates on the principles of comparability and competitiveness as examined by various studies, commissions, and agencies.

## A. COMPENSATION CONCEPTS AND PRINCIPLES

The idea of having guidelines or a codified set of principles for military compensation has been studied extensively. The general consensus is that such standards would help to regulate changes as well as to evaluate consistency, cost-effectiveness, and the logic of compensation proposals. (GAO/NSIAD-86-11, 1986, pp. 20-21)

The 5th QRMC believed that "any...compensation system should be based on certain underlying principles which... comprise its philosophy." (5th QRMC, 1984, p. II-1) The absence of a written set of standards, despite the belief they would be beneficial to the management of the compensation system, indicates disagreement over either the philosophy of compensation or the principles themselves. A review of compensation studies reveals basic agreement over fundamental principles or philosophies. Despite differences in terminology, many agencies such as the 5th and 7th QRMCs, DoD, and GAO, have supported the establishment of policy guidelines to provide an acceptable standard of living, offer flexibility, be acceptable to military personnel, support the military structure, offer pay visibility to the military and public, reward superior performance, and compensate for the X-factor. (GAO/NSIAD-86-11, 1986, p. 25) Additionally, independent studies, such as the 1978 Report of the President's Commission on Military Compensation, recognized the value of several of these principles (p. 11). The result would be a conceptual foundation for compensation that is both flexible and manageable, and additionally motivates members of the military.

Given the basic agreement on principles, the underlying philosophy of compensation should be examined. The main disagreement is a reflection of the different approaches to compensation, that is, institutional or market. Each approach espouses a method of achieving compensation equity. Generally, institutionalists support the concept of job comparability, while advocates of the market approach support the competitiveness principle. Although both approaches have the same goal of attracting and retaining the required military force, their support of different principles reflects the divergence of their compensation philosophies. (GAO/NSIAD-86-11, 1986, p. 26) Although

comparability and competitiveness have evolved into competing principles, some authors, such as Charles Moskos, maintain that the pay competitiveness model is actually an outgrowth of the pay comparability model.

### 1. Pay Comparability Principle

In 1982, Robert Komer and Robert B. Pirie, Jr. wrote the following dissent of a position paper prepared by the Atlantic Council's Working Group on Military Service:

> If pay comparability is maintained, and human resources are managed effectively, there is no reason why the nation's military manpower requirements cannot continue being met with volunteers. (Komer and Pirie, 1982, p. 308)

Many authorities in defense manpower would likewise agree that pay comparability is important to the success of the AVF. Pay comparability is defined as "setting and adjusting pay levels in one organization on the basis of wage surveys showing the compensation paid by other organizations." (GAO/NSIAD-86-11, 1986, p. 26) The 5th QRMC definition of pay comparability includes "equal pay for *substantially* equal work." (5th QRMC, 1984, p. II-3) This implies that the conditions of employment between organizations may be different, but there are facets of the jobs that are relatively comparable. Many problems under this philosophy have been created because analysts attempted to determine equal pay for equal work. The unique aspects and requirements of military life separate military service members from their civilian counterparts. Therefore, exact comparisons between the military and civilian sectors cannot be made. The 5th QRMC recognized this and argued for comparison of substantially equal work. With this consideration, there are several factors that can be used to compare military and private sector occupations for

potential pay comparisons. These factors are: 1) work performed; 2) knowledge, skills, and abilities; 3) job responsibilities; 4) age; and 5) education. (GAO/NSIAD-86-11, 1986, pp. 26-27)

These factors are vital measures to ensure that the internal labor market provides compensation comparable with competing employers. Employees working in an internal labor market place relatively high value on their career earnings. Pay comparability provides the mechanism to assure military compensation remains competitive throughout the service member's career. The wages established through pay comparability with the civilian sector become internalized and accepted in the military community. (Ehrenberg and Smith, 1991, p. 421)

There are several advantages gained by using pay comparability as a method for establishing compensation levels. Initially, comparing military wages with those earned in the private sector gives service members a feeling of equity. They believe they are being paid fairly at levels comparable to those they could earn outside the military. Similarly, pay comparability provides a logical method of wage analysis that military personnel and policy officials can understand and rely upon. Military members know what level of compensation they will receive for their efforts. The armed forces gain stability of pay for their manpower that is safe from frequent labor market adjustments. Finally, pay comparability proponents recognize the primary function of military service as armed combat. Therefore, they have supported the notion that basic pay rates should be the same for each grade and longevity step. (GAO/NSIAD-86-11, 1986, p. 27)

The results of pay comparability efforts are difficult to quantify because of the different wage rates paid for different occupations across the nation. Additionally, GAO

has reported that almost 20 percent of military jobs are combat-related with no civilian equivalent. However, an admittedly unscientific study of wage comparability reported by the Navy Times in 1993 revealed fairly consistent results with other studies. That is, service members with technical skills are underpaid, while those with general skills are better paid than their civilian counterparts. (Philpott, August 16, 1993, p. 12) This a consistent criticism of the institutional approach to compensation and highlights a major disadvantage of underpaying some members while overpaying others.

Opponents of pay comparability believe it is virtually impossible to achieve comparability because of the significant differences between military and civilian working conditions. Coupled with special manpower considerations required to staff the armed forces, pay comparability is difficult to fully implement. Finally, pay comparability may not even be required in an AVF, since service members do "volunteer" for more than pay alone. (GAO/NSIAD-86-11, 1986, p. 28) These criticisms are voiced by market supporters who prefer the competitive model.

The market supporters are not alone as opponents of pay comparability. Some proponents of institutional principles, oppose comparability as well. Their basic argument centers on continuance of the paternalistic elements of military compensation found in benefits, subsidized shopping, recreation, deferred income, and the like. Throughout the history of the armed forces and the AVF, the compensation system has been designed to take care of the member and his or her family. Highly paternalistic, the system has not openly identified service members as "employees" per se. One opponent, Captain John Greenbacker (USN), feels the shift toward pay comparability is a move toward treating service members as employees, that is, by rewarding

performance on the basis of work alone. Why retain any paternalistic features of the military compensation system, Greenbacker asks? If, in fact, service members are paid wages that are truly "comparable" to their civilian counterparts, why should there be any differences in compensation systems? (Greenbacker, 1978, p. 35)

**2. Pay Competitiveness Principle**

The pay competitiveness principle is based upon the market philosophy of compensation. This principle is rooted in labor supply and demand and states that military personnel be compensated at levels necessary for recruiting and retention programs. Pay competitiveness implies that the Services pay no more or no less than what is required to staff the nation's forces. The competitive nature of this system suggests that pay differentials be established based upon skill, education, and jobs tasks, and that pay be highly visible. Pay visibility requires that compensation be provided in competitive wages, as opposed to enticements, to ensure competitive comparability. (Moskos, 1978, p. 35)

The major advantage offered by the pay competitiveness principle is cost-effectiveness. The market approach achieves the desired force size and structure at the least cost. As stated in Chapter III, the market approach specifically targets job specialties required for the armed forces. Pay competitiveness is the method used here to determine the exact wages that employees should be paid. With this method, there is no underpayment or overpayment of personnel. There are no non-monetary benefits provided that the service member may or may not value. There is no excess compensation.

Conversely, the pay competitiveness model has several disadvantages. Critics believe that pay competitiveness would destabilize the military pay system by subjecting it

to labor market fluctuations. Existing shortages in the labor market, they find, would adversely affect the armed forces in their recruiting efforts through increased costs. Similarly, the system would increase costs required to maintain different pay tables for different occupations. The main arguments, however, center on the institutional nature of the armed forces, as discussed in Chapter III. As the embodiment of the market philosophy of compensation, pay competitiveness is said to entail all of the following drawbacks: 1) it undermines the hierarchical structure of the armed forces; 2) it dismantles many of the paternalistic features of military service; 3) it undermines the morale and motivation of service members by establishing disparate pay for equal commitment to defense of the nation; 4) it ignores the unique factors of military service (GAO/NSIAD-86-11, 1986, pp. 31-32); and 5) it leads service members to more closely relate to their civilian counterparts than to the members of the armed forces. (Moskos, 1978, p. 35)

## B. LESSONS LEARNED

### 1. No Set of Principles Exist

There is no formal set of compensation standards or principles for the AVF. Several studies, such as the Quadrennial Reviews of Military Compensation, have included statements of principles that should guide military compensation. However, reviews of these various materials show that the guidelines for military compensation have changed with each commission. Although the majority of studies on this topic find that development of compensation standards would benefit the nation, the military compensation system has operated throughout the AVF without them. (GAO/NSIAD-86-11, 1986, p. 35)

### 2. The Compensation System is Complex but Adequate

The military compensation system today contains elements of both pay comparability and competitiveness. The system is based primarily upon pay comparability. However, the system's S&I pays are a direct outgrowth of the pay competitiveness model. Despite the complexity of mixing these two philosophies in one system, the President's Commission on Military Compensation (1978) concluded that neither approach was preferable to the other and that the current system had done an adequate job determining appropriate pay ranges. (Report of the President's Commission on Military Compensation, 1978, p. 117) More recently, the 7th QRMC determined "(t)he existing pay and allowances structure has evolved and endured because it has helped build and maintain a robust military force." (7th QRMC, 1992, p. 3) The current system is a complex blend of competing principles, yet it has worked to provide a balanced and competent military force.

### 3. Development of Compensation Principles Would be Beneficial

There is basic agreement concerning the primary goals of the military pay system, and there is also little question that the current compensation system can support the future force structure. (7th QRMC, 1992, p. 4) However, the compensation system could be improved through the development of guiding principles. The potential benefits of having such principles include: 1) generating confidence in the armed forces and the public that compensation is set in a rational, logical manner; 2) providing military personnel with a benchmark upon which to evaluate their compensation; and 3) resolving the continuing controversy over whether military personnel are fairly and appropriately paid. (GAO/NSIAD-86-11, 1986, p. 35)

### 4. Pay Comparability is Required for Competitive Military Compensation

Pay comparability is needed for a competitive compensation program that can effectively recruit and retain the required number and type of military personnel. Equity and competitive career earnings for service members are also achieved through pay comparability. These advantages are congruent with the institutional philosophy and the military's internal labor market. The advantages provided by pay comparability significantly outweigh its disadvantages.

# V. POTENTIAL PROBLEM AREAS

Virtually every issue discussed in this chapter has been previously introduced in the study. However, these issues remain as potential problems for the military compensation system.

## A. ISSUES

### 1. The Dependency Factor[3]

Since 1918, the military compensation system has consistently provided additional compensation to service members who have dependents. Basic allowance for quarters may be the best known entitlement that is provided at different rates based solely upon marital status. However, it is not the only payment of this type. For example, the family separation allowance (FSA) is only paid to married service members who are restricted from residing with their dependents. In 1963, the Senate Committee on Armed Services felt that this restriction "result[ed] in an inequity as compared to those members whose dependents [were] authorized to accompany them." (MCBP, 1991, p. 685) The resultant FSA payments totalled $1.3 billion in 1990 alone. The enactment of FSA payments created another inequity between married and single members of the military. Single service members have no entitlement, despite working in the same restricted environment as their married counterparts.

Inequities also exist in benefits provided to married members for their dependents. Dependents are authorized access to the majority of subsidized, military facilities, such as commissaries, exchanges, movie theaters, and

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[3]This term is taken from Martin Binkin, The Military Pay Muddle, 1975.

recreational centers. Health care for dependents, the Survivor Benefit Plan, and the Dependency and Indemnity Compensation program all provide substantial benefits to the married member for which the single member receives no compensation and is ineligible to participate.

Despite these differences, the single most visible inequity between married and single personnel is in BAQ rates. Each month, the single member receives a pay statement and is reminded of the disparity between his or her lodging allowance and the allowance given to married members performing the same job, at the same duty station. Table 5-1 contains the 1990 BAQ rates, annotated to show the additional allowance given to married members solely because of their dependents. The percentage difference, or added compensation, was determined by dividing the payment difference (column 4) by the "without dependents rate" (column 2). The results in column 5 indicate that married members are compensated from 15 to 79 percent more than their single counterparts. As the armed forces continue to rely on labor market mechanisms for recruitment, paternalistic practices, such as the BAQ differences, could present problems.

### 2. Variable Food Allowance Rates

The DoD Pay Manual currently identifies four different types of BAS: one for officers and three for enlisted personnel. The three enlisted categories entail different degrees of availability of government mess facilities: 1) mess is available, but members are authorized to subsist separately; 2) rations-in-kind are not available; and 3) no government mess facilities are available. Table 5-2 contains the 1991 rates for BAS compared with the government's daily cost to feed service personnel. Since none of the rates are tied to actual food costs, the

Table 5-1

Comparison of BAQ Rates for Military Personnel, With and Without Dependents, by Pay Grade, 1990

| Grade | Without Dependents (dollars) | With Dependents (dollars) | Payment Difference (dollars) | Percent Difference |
|---|---|---|---|---|
| O7-O10 | 661.50 | 813.90 | 152.40 | 23.0 |
| O6 | 606.90 | 733.20 | 126.30 | 20.8 |
| O5 | 584.40 | 706.50 | 122.10 | 20.9 |
| O4 | 541.50 | 623.10 | 81.60 | 15.1 |
| O3 | 434.10 | 515.70 | 81.60 | 18.8 |
| O2 | 344.40 | 440.10 | 95.70 | 27.8 |
| O1 | 289.80 | 393.30 | 103.50 | 35.7 |
| W4 | 488.70 | 551.10 | 62.40 | 12.8 |
| W3 | 410.70 | 505.20 | 94.50 | 23.0 |
| W2 | 364.50 | 464.70 | 100.20 | 27.5 |
| W1 | 305.40 | 402.00 | 96.60 | 31.6 |
| E9 | 401.40 | 528.90 | 127.50 | 31.8 |
| E8 | 368.70 | 487.50 | 118.80 | 32.2 |
| E7 | 314.70 | 453.00 | 138.30 | 44.0 |
| E6 | 284.70 | 418.50 | 133.80 | 47.0 |
| E5 | 262.50 | 376.20 | 113.70 | 43.3 |
| E4 | 228.60 | 327.30 | 98.70 | 43.2 |
| E3 | 224.40 | 304.50 | 80.10 | 35.7 |
| E2 | 182.40 | 289.80 | 107.40 | 58.9 |
| E1 | 162.00 | 289.80 | 127.80 | 78.9 |

Source: Adapted from Military Compensation Background Papers, 1991, pp. 91-101.

disparity between the BAS rates creates actual wage differences between military service members. Table 5-2 indicates that, in 1991, enlisted personnel were overcompensated based upon actual food costs. A calculation

of 1.0 would indicate that personnel were provided BAS equal to the government's daily cost-to-feed a service member. Using this scale, the BAS payment differences, for the three classes of BAS, ranged from 16 (1.16) to 88 (1.88) percent for identical food requirements. All officers were under-compensated by 12 percent for similar food requirements. Although the differences between officer and enlisted rates are substantial, a major concern centers on the continuing discrepancies between enlisted rates.

### 3. Tax Advantage of Non-Taxable Allowances

Martin Binkin has argued that much of the problem surrounding the military compensation system stems from its complexity and the inability to accurately appraise the true value of in-kind benefits. (Binkin, 1975, p.18) Complicating appraisal efforts is the non-taxable status of housing (BAQ) and food (BAS) allowances and in-kind benefits. The tax-free provision of BAQ and BAS allowances is traced to a 1925 Court of Claims decision. The Court ruled that neither the provision of housing nor food nor monetary allowances provided in lieu of housing or food are subject to federal income taxation. (MCBP, 1991, p. 115)

Commonly referred to as "tax advantage," allowances have become a controversial component of military compensation. Prior to the 1940s, tax advantage was not a significant consideration because of the small amounts paid to service members in BAQ and BAS. However, throughout the history of the AVF, the monetary amounts paid have grown significantly along with the tax advantage. In 1975, Binkin estimated that the annual tax savings by military personnel ranged from $387 for a new recruit to $3,300 for a general officer. (Binkin, 1975, p. 21) By 1991, DoD estimated the advantage had grown to $691 and $5,057, for an E-1 and a

Table 5-2

Comparison of 1991 BAS Rates and Daily-Cost-to-Feed Estimates, by Availability of Mess Facility and Grade

| Category | E1 (under 4 months) (dollars) | Percent of food cost (dollars) | E1 (over 4 months) to E9 (dollars) | Percent of food cost | Officers | Percent of food cost |
|---|---|---|---|---|---|---|
| Daily Cost-to-Feed | 4.90 | -- | 4.90 | -- | 4.90 | -- |
| Member permitted to mess separately | 5.68 | 1.16 | 6.15 | 1.26 | 4.30 | 0.88 |
| Rations in-kind not available | 6.41 | 1.31 | 6.94 | 1.42 | 4.30 | 0.88 |
| Govt mess not available | 8.50 | 1.73 | 9.20 | 1.88 | 4.30 | 0.88 |

Source: 1991 Daily Cost-to-Feed Rate from the 7th QRMC, 1992, p. 62. 1991 BAS rates from the DoD Pay Manual.

general officer, respectively. Table 5-3 contains the data from DoD with potential low, high, and average ranges.

Calculations of tax advantage can only be estimated because each individual gains a tax advantage based upon his or her unique financial situation. Individual tax advantage depends on: 1) the amount of basic pay received, based upon grade and time-in-service; 2) the value of BAQ and BAS received; 3) the number of personal exemptions; and 4) the member's marital status. (MCBP, 1991, p. 123) Because of its complexity "the number of military personnel, defense officials, and legislators who understand the concept of tax advantage...is probably very small." (Binkin, 1975, p.21)

An additional tax advantage can be received by service members whose legal state of residence has no income tax or does not tax military income. Appendix C contains an explanation of states that have no income tax or provide differential income tax treatment for military personnel.

Table 5-3

Estimates of Tax Advantage for Military Personnel, by Pay Grade, 1991

| Pay Grade | Low Range of Tax Advantage (dollars) | High Range of Tax Advantage (dollars) | Average Tax Advantage (dollars) |
|---|---|---|---|
| O-10 | 4,262 | 5,083 | 5,057 |
| O-9 | 4,262 | 4,983 | 4,893 |
| O-8 | 4,262 | 4,616 | 4,518 |
| O-7 | 4,262 | 4,400 | 4,397 |
| O-6 | 1,826 | 4,024 | 4,018 |
| O-5 | 1,769 | 3,899 | 3,701 |
| O-4 | 1,593 | 3,129 | 2,258 |
| O-3 | 1,365 | 2,789 | 1,755 |
| O-2 | 1,135 | 2,461 | 1,620 |
| O-1 | 882 | 2,201 | 1,055 |
| W-4 | 1,440 | 2,883 | 1,594 |
| W-3 | 1,343 | 2,519 | 1,399 |
| W-2 | 1,252 | 2,303 | 1,338 |
| W-1 | 571 | 2,027 | 1,153 |
| E-9 | 1,516 | 2,746 | 1,572 |
| E-8 | 1,428 | 2,594 | 1,480 |
| E-7 | 1,100 | 2,342 | 1,383 |
| E-6 | 457 | 1,325 | 1,247 |
| E-5 | 31 | 1,388 | 1,108 |
| E-4 | 0 | 1,267 | 975 |
| E-3 | 0 | 1,184 | 895 |
| E-2 | 0 | 1,010 | 797 |
| E-1 | 0 | 842 | 691 |

Source: From Military Compensation Background Papers, 1991, p. 127.

The complexity of the system has led to three major arguments in favor of taxing BAQ and BAS allowances. Initially, service members would gain a better appreciation for the true value of their compensation package. The problem of the current non-taxable system is that personnel underestimate the tax advantage. Second, such a move would remove the inequities of the current system. Presently, the system favors persons in higher tax brackets, single personnel, senior military members, and those with no outside income. Finally, providing taxable allowances would show the actual cost of the armed forces. For example, in 1985, DoD estimated that the cumulative tax advantage for military personnel was about $2.5 billion. (GAO/NSIAD-86-11, 1986, pp. 61-62) This is not recorded as a cost for the armed forces. Instead, it is lost tax revenue, not collected from service members.

**4. Defense Employment Cost Index**

As discussed in Chapter II, automatic pay adjustments have been a continuing process since implementation of the AVF. The DECI recommended by the 7th QRMC, and developed in coordination with RAND, appears to be the next evolutionary step. The DECI is designed to more accurately reflect the demographic composition of the armed forces. In fact, the military contains a higher concentration of 18-to 30-year-olds than in the civilian population. The DECI would use data from the Current Population Survey and weight reported civilian wages to reflect the military population. In this manner, the DECI can combat a common criticism of other indexes by better matching pay adjustments to the military's demographics. Matching wages in this manner would be an advantage to the majority of youthful service members, but it may become a disadvantage to the older, career members of the military who find their pay lagging

behind that of their civilian counterparts. (7th QRMC, 1992, pp. 113-115)

### 5. Entry-Level Pay Changes

An internal labor market dictates that entry into an organization occurs only at the entry level. Such is the case for the armed forces. Individuals are recruited to enter military service primarily at the entry level (some exceptions exist for doctors, dentists, etc.). Higher positions within the military are filled by service members who have "worked their way up the ranks." A recent concern raised in the 7th QRMC is whether or not pay can be reduced for recruits at the entry level. Considering budget cutbacks, force drawdowns, and force structure uncertainties, this could clearly become a heated topic of debate in the near future. The analysis conducted by the 7th QRMC supports a slight slowdown in the pay rates for new recruits. However, the Commission cautions against retarding pay rates without considering all potential variables. (7th QRMC, 1992, pp. 142-143)

## B. LESSONS LEARNED

### 1. Basic Allowance for Subsistence Rates are Inequitable

Unlike BAQ, BAS has no relationship with the member's marital status or number of dependents. Therefore, the different rates paid to service members cannot be justified on institutional or paternalistic grounds. Similarly, the different rates cannot be justified through market analysis, since none of the rates reflect the government's estimate of the cost-to-feed. The allowance for subsistence is designed "to provide a cash allowance to members of the armed forces

to defray a portion of the cost of subsistence." (MCBP, 1991, p. 103) Ignoring differences in physical size, appetites, and individual tastes, the majority of military personnel have comparable food costs. Therefore, if meals are not provided to personnel expense-free, all service members, regardless of rank, should be entitled to the same subsistence allowance.

**2. Annual Pay Adjustments are Evolving**

Continuing research on the DECI indicates the concept of annual pay adjustments for service members has developed into an expected component of the military compensation program. Prior to the implementation of the AVF, this was not the case. Pay adjustments were haphazard and not provided on a regular basis. However, development of the DECI shows the intent to match the military's demographics with wages appropriate for the force. By matching wages and demographics, the nation will be able to provide competitive compensation to obtain the desired armed force.

**3. Tax Advantage is Inequitable and Misleading**

The tax advantage provided through tax-exempt allowances is inequitable because the benefit gained is dependent upon each individual's specific situation. Not only does this system provide greater compensation to one member over another, but it masks the true costs of maintaining an armed force. The tax advantage shifts part of the burden of paying for the force from actual monetary outlays to revenue losses from taxable income. The tax advantage also raises two important questions for personnel policy makers. First, do service members sufficiently understand and appreciate the gain created through nontaxable allowances? Second, does the nation understand the true cost associated with maintaining the armed forces?

# VI. SUMMARY AND CONCLUSIONS

The end of the draft in 1973 required the development of a compensation philosophy that would enable the nation to attract and retain the necessary numbers and quality of personnel for voluntary service in the armed forces. Initially, the nation had to resolve several fundamental differences of opinion with respect to a citizen's obligation to serve, the character of the military, equity of service, and the President's ability to wage war, among others. (DoD, 1978, p. 229) The Gates Commission studied these concerns and the nation's ability to staff the armed forces through all-volunteer means. The Commission's recommendations on the issues of the tax-in-kind paid by conscripts and the desire to spread the economic burden of national defense to all taxpayers finally helped to end the military draft in 1973. The compensation system that has evolved since 1973 has reflected many of these challenges. Frequently, concerns over cost and rising pays became focal points for adversaries of all-voluntary service.

The AVF itself raised many issues for the nation's compensation specialists. A difficult matter to address centered on the X-factor, or the unique requirements of military service. The recognition that military service limits an individual's freedoms and requires contracted service periods, created a compensation quandary for AVF supporters and opponents alike. As the nation has grown to internalize the concept of the AVF, we have witnessed the continual improvement and development of the compensation system to address these dilemmas. The primary method of evaluating military pay has traditionally been through regular military compensation, which is comprised of basic pay and allowances for food and housing.

The desire to have a consistent and competitive system for compensating personnel is witnessed through the development of automatic pay adjustments. The nation has experimented with two different adjustment mechanisms throughout the history of the AVF. A third method was proposed in 1993 and it is still under review. Each new mechanism has been an incremental improvement over its predecessor.

Basically, there are two general methods for determining military pay and benefits. These are called the institutional and market approaches. Proponents of the institutional approach believe that every service member's role is to defend the United States, regardless of his or her assigned occupational specialty. The compensation system should be designed to encourage equal commitment to the armed forces and national defense, they maintain, regardless of any skill or job differences. They further support the paternalistic application of benefits to all personnel. Thus, deferred income, in-kind payments, and benefits based upon the need of service members are consistent with their philosophy.

Conversely, proponents of the market approach support a skill-based compensation program that places higher worth on the individual. They do not place equal value on the contributions of service members who have different occupational skills or abilities. The significance of personal capabilities, they say, should be determined by supply and demand criteria in the open market. The market approach is highly individualistic, placing emphasis on current income and the personal preferences of military personnel.

As it turns out, the current system of military compensation is a balanced blend of institutional and market philosophies. It is based upon an institutionally desired

base of pay and benefits provided to all service members. The market then dictates what additional incentives and bonuses are paid to attract and retain critical personnel or recruit for hard-to-fill positions. This combination has been critical because of the military's closed manpower system and internal labor market. The closed system requires that entry-level positions be filled from the labor market. All subsequent positions are filled by personnel from within the armed forces. The military has consequently developed an approach to pay that is competitive enough to attract new recruits and encourage career service.

The clash between institutional and market approaches can also be seen in their separate philosophies on setting levels of military pay. Institutionalists primarily support the concept of pay comparability. Pay comparability compares the military with similar civilian occupations and strives to achieve equal pay for substantially equal work. The ultimate objective is to obtain adequate wages that will continue to attract and retain qualified personnel to the armed forces. Proponents of the market approach, on the other hand, support the concept of pay competitiveness, which allows military wages to be based upon labor market rates. By targeting wage rates in specific fields, they claim the military can be staffed at considerable savings over the universal approach recommended by institutional thinkers. Once again, the approach toward military compensation that has evolved since the end of the draft creates a mix of both comparability and competitiveness, balancing aspects of the market and institutional philosophies. Suffice it to say, the development of a workable system of compensation for the AVF has involved a myriad of controversies, disagreements, failures, and successes.

This study has identified 18 "lessons learned" from the development of the compensation system over the past twenty years. In summary, they are as follows:

1. Wage comparability surveys are inaccurate. Neither the PATC nor the ECI have effectively captured the demographics of the military.

2. Automatic wage adjustments are poorly executed. Both the PATC and ECI are measures of labor wage rates. Universal application of these increases to housing and food allowances does not amount to an efficient use funds.

3. The intent of allowances is good. However, the application of wage rate increases has removed the correlation between BAS and BAQ and the costs they are intended to defer.

4. Compensation initiatives have had a powerful effect on personnel recruiting and retention. Wage rates, allowances, and benefits will continue to influence the ability of the armed forces to recruit and retain the necessary quantity and quality of personnel.

5. Educational benefits likewise affect personnel recruiting and retention. Post-service educational incentives play an important role in attracting new recruits, but they also encourage people to leave the military.

6. The compensation system is perceived as being equitable. This is apparent in the continuing success of the AVF to attract and retain highly-qualified personnel and in other measures of force effectiveness and performance.

7. Bonuses are efficient and flexible. Selective enlistment and reenlistment bonuses have allowed the nation to provide a base pay for all service members and provide added incentives, as required, to maintain the AVF.

8. S&I pays are vital for force management. These pays provide additional pay to attract and retain required personnel in difficult-to-fill positions. Without S&I pays, the military would have to overpay the majority of the force to obtain critical personnel.

9. S&I pays should be updated regularly. Because of their importance, these pays should be evaluated and revised on a regular basis.

10. Institutional and market approaches to compensation are both important, but neither is satisfactory by itself. The current blend of elements from each approach has worked well for the AVF.

11. The internal labor market is consistent with institutional strategies. The internal labor market encourages several practices, such as career earnings value, that are consistent with the institutional philosophy.

12. No set of codified principles on compensation currently exist. The military compensation system has evolved in an often-haphazard, disorganized, and conflicting fashion.

13. The compensation system is complex but adequate. The current system is a complex blend of several competing principles, yet it has worked to provide a balanced and competent military force.

14. The development of guiding principles for military compensation policy would be beneficial. These guidelines would generate confidence in the ability of the compensation system to meet the needs of the armed forces, individual service members, and the nation.

15. Pay comparability is required for competitive military pay. Pay comparability provides the means to access the potential of career earnings required in an internal labor market.

16. Basic allowance for subsistence rates are inequitable. The different rates for service members bear no relation to needs or dependency factors. The various rates and resulting differences cannot be defended on the basis of either the institutional or market philosophy.

17. Annual pay adjustments are evolving. The proposed DECI is the next effort to better match the demographics of the military with the civilian populace and obtain a more accurate comparison of wages.

18. Tax advantage is inequitable and misleading. The tax advantage incurred is highly dependent upon individual factors, such as marital status, which affects the member's tax liabilities. Additionally, the tax advantage masks the true cost of manning the armed forces.

Each lesson learned should be considered on its own merit. However, there are two major points that encompass all eighteen lessons. First, the compensation system is very complex. It is a hybrid approach that incorporates features of both the institutional and market concepts. Because of this complexity, it is difficult to compare wages, allowances, and benefits, provided to service members with those provided in the civilian sector. Attempts to ensure equity or competitiveness are noble but difficult to fulfill because of the way in which the system has evolved.

Additionally, it must be recognized that this hybrid approach to compensation has been successful. The system has worked to provide a military force highly capable of defending the nation's interests at home and abroad. Furthermore, the system has been flexible enough to adjust as required in attracting and retaining adequate numbers and quality of personnel. Even through the darkest period of the AVF, the so-called "hollow force" of the late 1970s, military compensation was manipulated to provide additional

basic and incentive pays and help restore the force to required levels. The resulting success of the system can be largely attributed to: 1) adoption of important principles from both the institutional and market approaches to military compensation; 2) a prevailing "can-do" attitude on the part of government officials to make the AVF work; 3) the many studies and analyses by various agencies and commissions of what works and what does not; and 4) as the Gates Commission speculated, the patriotism and dedication of American youth (Gates, 1970, p.6).

Although the compensation system has been flexible enough to meet force needs, there are still several areas that can be improved. Initially, the flexibility of the system is challenged on a regular basis because the nation has not adopted a formal set of compensation principles (7th QRMC, 1992, p. 151). The potential benefit of compensation principles was discussed in Chapter IV. To ensure consistency throughout evolutionary compensation adjustments, a set of underlying principles should be adopted.

Second, the unique blend or balance of the institutional and market philosophies should be continued. Each ideology has both positive and negative aspects with respect to military compensation. By using selected aspects of each program, the nation can build an effective program. While it may be true that a cheaper system could be implemented through a pure market approach, the question arises as to whether this would create a force the nation wants or needs. The unique considerations of the X-factor, or the special demands of military service, do not easily relate to market analysis. At the same time, the institutional concept of citizen responsibility, patriotism, and service in behalf of the nation's defense should not be abandoned.

Several aspects of the market approach are extremely vital to an effective compensation system. The adjustments to BAS and BAQ rates should be tied directly to food and housing costs. The BAS rates provided to individual service members should not only reflect food costs, but should be uniform across grades. There is little justification for two service members of the same grade, neither of which is provided government meals, to be paid different rates of BAS. It is not only a gross inequity, but it further complicates the compensation system.

Despite certain inequities and minor inconsistencies, the compensation system has done a good job of meeting the needs of the armed forces. Earlier in Chapter I, the Gates Commission was quoted from its 1970 final report stating that a

> fundamental consideration that has guided this commission is the need to maintain and improve the effectiveness, dignity, and status of the armed forces so they may continue to play the proper role. (Gates Commission, 1970, p. 5)

During the past twenty years the compensation system has complemented that consideration and has provided the United States with an effective, proud, and dignified armed force.

## APPENDIX A. PAYS AND ALLOWANCES SUMMARY

| Title | Monetary Range | Year Began | Last Change |
|---|---|---|---|
| Acceleration Subject Duty Pay | $110 per month | 1955 | 1985 |
| Aviation Career Incentive Pay | $125-650 per month | 1974 | 1989 |
| Aviation Officer Continuation Pay | Up to $12,000 per year | 1980 | 1989 |
| Basic Pay | $753.60-9,016.80 per month | 1790 | 1993 |
| Career Sea Pay | $50-520 per month | 1835 | 1987 |
| Certain Places Pay | $8-22.50 per month | 1900 | 1949 |
| Clothing Maintenance Allowance | $151.20-288 per year | 1949 | 1989 |
| Combat Pay | $110 per month | 1952 | 1985 |
| Death Gratuity | $3,000 | 1908 | 1986 |
| Deceleration Subject Duty Pay | $110 per month | 1955 | 1985 |
| Demolition Duty Pay | $110 per month | 1949 | 1985 |
| Dental Officer Special Pay | $100-500 per month | 1967 | 1985 |
| Dependency and Indemnity Compensation | $594-1,633 per month | 1957 | 1991 |

| | | | |
|---|---|---|---|
| Dislocation Allowance | 2 months' BAQ | 1955 | 1985 |
| Diving Duty Pay | Up to $300 per month | 1886 | 1981 |
| Engineering and Scientific Career Continuation Pay | Up to $3,000 per year | 1981 | 1981 |
| Enlistment Bonus | Up to $12,000 | 1791 | 1989 |
| Family Separation Allowance | FSA I-Up to 1 months' BAQ | 1963 | 1981 |
| | FSA II-Up to $75 per month | 1963 | 1991 |
| Flight Deck Duty Pay | $110 per month | 1965 | 1985 |
| Flight Pay (air weapons) | $125-350 per month | 1981 | 1981 |
| Flight Pay (crew) | $110-250 per month | 1913 | 1985 |
| Flight Pay (non-crew) | $110 per month | 1934 | 1985 |
| Foreign Language Proficiency Pay | Up to $100 per month | 1986 | 1986 |
| High Pressure Chamber Duty Pay | $110 per month | 1963 | 1985 |
| Low Pressure Chamber Duty Pay | $110 per month | 1955 | 1985 |
| Nuclear Career Accession Bonus | Up to $8,000 | 1976 | 1985 |
| Nuclear Career Annual Incentive Bonus | Up to $10,000 per year | 1976 | 1985 |

| | | | |
|---|---|---|---|
| Nuclear Qualified Officers Continuation Pay | $12,000 per year up to a total of $60,000 | 1969 | 1985 |
| Operational Submersible Duty Pay | $75-595 per month | 1960 | 1987 |
| Overseas Duty Extension Pay | Up to $80 per month | 1980 | 1985 |
| Overseas Stations | (Variable based on exchange rates) | | |
| COLA | $10-3,500 per month | 1942 | 1993 |
| OHA | $0-3,600 per month | 1942 | 1993 |
| Parachute Duty Pay | $110 per month ($165 HALO) | 1941 | 1985 |
| Personal Exposure Pay | $110 per month | 1981 | 1985 |
| Personal Money Allowance | $41.67-333.33 per month | 1922 | 1949 |
| Quarters Allowance | $6.90-879.60 per month | 1878 | 1993 |
| Reenlistment Bonus | Up to $45,000 | 1791 | 1989 |
| Responsibility Pay | $50-150 per month | 1958 | 1958 |
| Retired Pay | Up to 75% of monthly base pay | 1861 | 1987 |
| Separation Pay (nondisability) | 120% of product of years of service times monthly base pay | 1880 | 1990 |
| Severance Pay (disability) | Up to 2 years basic pay | 1949 | 1975 |

| | | | |
|---|---|---|---|
| Special Duty Assignment Pay | Up to $275 per month | 1958 | 1984 |
| Special Incentive Pay for Health Professionals | Up to $22,000 per year | 1947 | 1991 |
| Submarine Duty Incentive Pay | $75-595 per month | 1901 | 1987 |
| Subsistence Allowance | $4.65-9.94 per day | 1808 | 1993 |
| Thermal Experiment Subject Pay | $110 per month | 1957 | 1985 |
| Toxic Fuels and Propellants Exposure Pay | $110 per month | 1981 | 1985 |
| Variable Housing Allowance | Up to $716 per month | 1981 | 1991 |

Source: Military Compensation Background Papers, 1991, pp. xiii-xiv.

# APPENDIX B. 7TH QRMC CLASSIFICATION OF SPECIAL AND INCENTIVE PAYS

The 7th QRMC recognized that the purpose of S&I pays has changed over the years, as explained in Chapter III. To better manage these pays, the commission proposed the following classifications: hazardous duty, career incentive, and skill incentive. This categorization of S&I pays provides a vivid demonstration of how their purpose has changed over the years.

| Category | Type of Pay |
|---|---|
| Hazardous Duty | Flight Pay (not as a crew member) |
| | Parachute Duty |
| | Demolition Duty |
| | Pressure Chamber Duty |
| | Acceleration or Deceleration Experimental Subject |
| | Thermal Stress Test Subject |
| | Flight Deck Duty |
| | Toxic Pesticide, Virus, or Bacteria Exposure |
| | Handling Toxic Fuels |
| | Hostile Fire Pay |

| Career Incentive | Flight Pay (crew member and air weapons) |
|---|---|
| | Aviation Career Incentive Pay |
| | Diving Duty |
| | Career Sea Pay |
| | Special Duty Assignment |
| | Overseas Extension Pay |
| | Submarine Duty |
| | Foreign Language Proficiency |
| | Medical Officers Board Certification |
| | Medical Officers Variable Special |
| | Dental Officers Board Certification |
| | Dental Officers Variable Special |
| | Optometrists Regular Special |
| | Psychologists |
| | Nonphysicians Health Care Providers |
| | Veterinarians |
| | Certain Places Pay |
| | Assigned to an International Military Headquarters |

| | |
|---|---|
| Skill Incentive | Selective Reenlistment Bonus |
| | Nuclear Qualified Enlisted Members |
| | Nurse Anesthetists |
| | Optometrists Retention Special Pay |
| | Aviation Career Officers Extending Active Duty |
| | Engineering and Science Career Continuation |
| | Acquisition Corps Continuation Bonus |
| | Medical Officers Multiyear Retention Bonus |
| | Medical Officers Incentive Special Pay |
| | Nuclear Qualified Officers Extending Active Duty |
| | Nuclear Career Annual Incentive Bonus |
| | Dental Officers Additional Special Pay |
| | Medical Officers Additional Special Pay |
| | Enlistment Bonus |
| | Army Enlistment Bonus |
| | Accession Bonus for Registered Nurses |
| | Nuclear Career Accession Bonus |

Source: 7th QRMC, 1992, pp. 100-101.

## APPENDIX C. STATE INCOME TAX PROVISIONS

The tax advantage gained by each individual service member is affected, not only by federal tax codes, but also by the treatment of military compensation as taxable income at the state level as well. In the majority of states, military compensation is included in income subject to taxation under the same terms as is income under federal tax codes. However, each state's tax code provides different exemptions and credits for military compensation of legal state residents. The following chart indicates those states that provide added tax advantage to members of the armed forces. The tax information is taken from Military Compensation Background Papers, 4th edition, 1991, pp. 730-738.

| No State Tax or Tax on Earned Income | No State Tax on Military Compensation | No State Tax on Members not Stationed in State |
|---|---|---|
| Alaska | Illinois | California |
| Florida | Michigan | New York |
| Nevada | Vermont | Pennsylvania |
| New Hampshire | | |
| South Dakota | | |
| Tennessee | | |
| Texas | | |
| Washington | | |
| Wyoming | | |

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